IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

No. 76-1362

COMMUNITY LOAN & INVESTMENT CORPORATION OF FULTON COUNTY,
Petitioner,

versus

ROSE E. JONES,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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Petitioner Community Loan & Investment Corporation of Fulton County respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in this case on December 13, 1976, which judgment reversed and remanded the judgment in favor of petitioner entered by the United States District Court for the Northern District of Georgia.

OPINIONS BELOW

The opinion of the Fifth Circuit Court of Appeals, entered upon rehearing on December 13, 1976, is reported at 544 F.2d 1228, and is reprinted in Ap-

pendix A. The original opinion of the Circuit Court issued January 30, 1976, is reported at 526 F.2d 642 and is reprinted in Appendix B. The Order denying petitioner's petition for a rehearing and rehearing *en banc*, entered January 10, 1977, is reported at 545 F.2d 1298. The opinion of the District Court is not reported, but is reprinted in Appendix C. The recommendation and opinion of the bankruptcy judge who sat as a special master in this case, which opinion and recommendation is referred to in the Order of the District Court, is not reported, but is reprinted in Appendix D.

JURISDICTION

Judgment in this case was originally entered on January 30, 1976. A petition for rehearing was timely filed, and rehearing was granted. The opinion on rehearing was issued and the judgment thereon entered on December 13, 1976. A petition for rehearing by the court sitting *en banc* was filed on December 27, 1976, and the Order denying said petition for rehearing *en banc* was entered January 10, 1977. The jurisdiction of this Honorable Court is invoked under 28 U.S.C. §1254(1).

QUESTION PRESENTED

May the Circuit Court of Appeals refuse to follow a Federal Reserve Board interpretation of a regulation promulgated by the Board, when that interpretation is not clearly erroneous or inconsistent with the regulation?

STATUTES AND REGULATIONS INVOLVED

This case involves the following statutes and regulations, all of those not reprinted here being reprinted in pertinent part in Appendix E:

Acts Of Congress

Title I of the Consumer Credit Protection Act, known as the Truth-in-Lending Act, §§103b; 105; 106; 121(a); 122(a); 129; 130(a), (b), (d), (e), and (f); Pub. L. 90-321, Title I, §§103(b), 105, 106, 121(a), 122(a), 129, 130(a), (b), (d), and (e), May 29, 1968; 82 Stat. 147, 148, 152, 156, and 157, as amended by Pub. L. 93-495, Title III §§307(c) and (e) and Title IV §§406, and 408(a),(b), and (e), October 28, 1974; 88 Stat. 1516, 1518; 15 U.S.C. §§1602, 1604, 1605, 1631, 1632, 1639, and 1640.

Statutes Of The State Of Georgia

The Georgia Industrial Loan Act, Acts 1955, pp. 431, 440; Georgia Code §§25-315(a) and (b), which provides in pertinent part:

> "Every licensee hereunder may loan any sum of money not exceeding $3,000 for a period of 36 months and 15 days or less and may charge, contract for, collect and receive interest and fees, and may require the fulfillment of conditions on such loans as hereinafter provided:
>
> (a) *Basic interest; advance discounts*
>
> Charge, contract for, receive and collect interest at a rate not to exceed eight per cent. per annum of the face amount of the contract, whether repayable in one single payment or repayable in

monthly or other periodic installments. On loan contracts repayable in 18 months or less, the interest may be discounted in advance, and on contracts repayable over a greater period, the interest shall be added to the principal amount of the loan. On all contracts, interest or discount shall be computed proportionately on equal calendar months.

(b) *Fee for making loan*

In addition thereto, charge, contract for, receive, or collect at the time the loan is made, a fee in an amount not greater than eight per cent. of the first $600 of the face amount of the contract, plus four per cent. of the excess."

Regulations

Truth in Lending Regulations, Regulation Z, §§226.4(a); 226.8(c)(6); 226.8(d)(1), (2) and (3); 226.8(e)(1); 34 FR 2002, February 11, 1969, 34 FR 5327, March 18, 1969; and §226.819, 38 FR 23513, August 31, 1973, which states:

> "Sections 226.8(c)(6), 226.8(d)(2) and 226.8(e)(1) require that certain finance charges be disclosed as 'prepaid finance charges.' They also require that such prepaid finance charges be excluded or deducted from the credit extended in arriving at the 'amount financed.' The question arises whether add-on, discount or other precomputed finance charges which are reflected in the face amount of the debt instrument as part of the customer's obligation, but which are excluded from the 'amount financed,' must be labeled as 'prepaid' finance charges.

> The concept of prepaid finance charges was adopted to insure that the 'amount financed' reflected only that credit of which the customer had the actual use. Precomputed finance charges which are included in the face amount of the obligation are not the type contemplated by the 'prepaid' finance charge disclosure concept. Although such precomputed finance charges are not to be included in the 'amount financed,' they need not be regarded as finance charges 'paid separately' or 'withheld by the creditor from the proceeds of the credit extended' within the meaning of §226.8(e) to require labeling 'prepaid' under §226.8(c)(6) and 226.8(d)(2). They are 'finance charges,' of course, to be disclosed under §226.8(c)(8) and 226.8(d)(3)." 12 C.F.R. §226.819.

Public Information Letters

Public Information Letter dated January 18, 1972, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶30,794; Letter 379, July 29, 1970, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶30,560, Letter 397, August 7, 1970, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶30,581.

STATEMENT OF THE CASE

Petitioner is licensed to lend money under the Georgia Industrial Loan Act, and on May 30, 1972, Petitioner and Respondent Jones entered into a loan transaction subject to Title I of the Consumer Credit Protection Act, commonly referred to as the Truth-in-Lending Act, 15 U.S.C. §1601 *et seq.* (herein-

after sometimes referred to as "the Act"). In connection with the loan transaction, Respondent Jones received a copy of a loan disclosure statement as required by the Act and by the Truth-in-Lending Regulations, Regulation Z, 12 C.F.R. §226, promulgated by the Federal Reserve Board pursuant to Congressional authority. The loan disclosure statement showed that certain precomputed loan fees had been charged to Jones and added to the amount which she was to repay in installments over a period of time as permitted by Georgia law. These fees were not labeled as a "prepaid finance charge," but were clearly disclosed as part of the "finance charge."

After repaying the loan, Jones filed a complaint in the United States District Court for the Northern District of Georgia on May 30, 1973, invoking the District Court's jurisdiction under 15 U.S.C. §1640 (e) (§130 of the Act) and seeking statutory damages in the amount prescribed by §130 of the Act, 15 U.S.C.§ 1640(a), on the basis of alleged, but unspecified, violations of the Act and the Regulation.

Subsequently Jones moved for summary judgment, contending, *inter alia*, that the loan fees authorized by Georgia law should have been disclosed as a "prepaid finance charge" under Regulation Z §226.8, 12 C.F.R. §226.8. This contention, as well as others raised in the motion, was rejected by the District Court.[1] The Order of the District Court cited as authority other decisions in the District which had relied upon a formal interpretation of Regulation Z §226.8 promulgated by the Federal Reserve Board on August 23, 1973. 12 C.F.R. §226.19. That interpretation specifically addressed the issue of the disclosure of precomputed add-on type charges as a "prepaid finance charge" and concluded that such charges need not be labeled "prepaid". Judgment in favor of Petitioner was entered on July 18, 1974, the court concluding that the disclosure statement in evidence showed no violations of the Act or Regulation. Appendix C.

[1] The matter was first referred to a Bankrupcy Judge sitting as Special Master pursuant to Local Rule 250 of the Northern District of Georgia; the Bankruptcy Judge's opinion and recommendations are set forth in Appendix D and were approved and adopted by the District Court.

That judgment was appealed to the Court of Appeals for the Fifth Circuit and in an opinion entered January 30, 1976, the Court of Appeals for the Fifth Circuit reversed and remanded the cause to the District Court. That opinion recognized the lower courts' reliance on the Board's formal interpretation, Regulation Z §226.819, but concluded that the interpretation did not apply to the Georgia loan fees, 526 F.2d at 647-8. Holding that Petitioner's failure to describe the Georgia loan fee as a "prepaid finance charge" entitled Jones to relief under the Act, the Circuit Court panel did not reach or decide other assignments of error. 526 F.2d at 649.

Petitioner thereafter filed a motion for rehearing and reconsideration, setting forth as its first ground in support thereof a letter issued by the Board of Governors of the Federal Reserve System which addressed the January 30, 1976 decision by the Fifth Circuit Court of Appeals in this case, and suggested the Board's willingness to express its views to the Court in a brief *amicus curiae* (Appendix F.) The

Circuit Court panel invited the Board of Governors to express its views *amicus curiae* (Appendix G), and the Board accepted the invitation by filing a brief within the time allowed by the court (Appendix H).

After noting "the importance of this case as a precedent under the Truth-in-Lending Act," the *amicus curiae* brief of the Board went on to reiterate its position set forth in its previous interpretation of August 23, 1973, and to state that the "prepaid finance charge" regulation was not intended to require Petitioner to disclose as a "prepaid finance charge" the type loan fees charged in connection with the subject transaction.

In a second opinion in this case, entered by the Circuit Court of Appeals on December 13, 1976, two of the original three-judge panel granted rehearing, expressly rejected the Federal Reserve Board's interpretation of its own Regulation, and again reversed and remanded this cause to the District Court. 544 F.2d 1228.

Petitioner respectfully petitions this Court for a writ of certiorari to the Court of Appeals for the Fifth Circuit to review and reverse that court's decision in *Rose E. Jones v. Community Loan & Investment Corporation of Fulton County*, No. 743586 in that court.

REASON FOR GRANTING THE WRIT

The Court Of Appeals For The Fifth Circuit Has Decided A Federal Question In A Way In Conflict With Applicable Decisions Of The Supreme Court

Of The United States In That The Circuit Court Has Refused To Follow A Federal Reserve Board Interpretation Of A Regulation Promulgated By The Board When That Interpretation Is Not Clearly Erroneous Or Inconsistent With The Regulation.

The decisions of this Honorable Court have clearly set forth rules to be applied by courts when construing administrative regulations, which demand deference to the administrative interpretation of the regulation unless the interpretation is clearly erroneous:

> "This court is not at liberty to substitute its own discretion for that of administrative officers who have kept within the bounds of their administrative powers. To show that these have been exceeded in the field of action here involved, it is not enough that the prescribed system . . . shall appear to be unwise or burdensome or inferior to another. Error or unwisdom is not equivalent to abuse." *American Telephone & Telegraph Co. v. United States*, 299 U.S. 232, 236-37, 57 S.Ct. 170, 172 (1936). (Citations omitted.)

> "When the construction of an administrative regulation rather than a statute is in issue, deference is even more clearly in order. 'Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt. * * * [T]he ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation.' *Bowles v. Seminole Rock Co.*, 325 U.S. 410,

413-414, 65 S.Ct. 1215, 1217, 89 L.Ed. 1700." *Udall v. Tallman*, 380 U.S. 1, 16-17, 85 S.Ct. 792, 801 (1965).

In *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 93 S.Ct. 1652 (1973), which dealt specifically with Truth-in-Lending regulations promulgated by the Federal Reserve Board, this Court reversed the Fifth Circuit Court of Appeals and set forth the following mandate:

> "We have consistently held that where reasonable minds may differ as to which of several remedial measures should be chosen, courts should defer to the informed experience and judgment of the agency to whom Congress delegated appropriate authority." 411 U.S. 356, 371-72, 93 S.Ct. 1652, 1662.

Even though the Court of Appeals for the Fifth Circuit has heretofore recognized the mandate of *Mourning*, *Udall*, and *Bowles supra*, *see Philbeck v. Timmers Chevrolet, Inc.*, 499 F.2d 971, 976-77 (5th Cir., 1974), in the instant case that mandate was totally ignored by that Court. In its first opinion in this case, 526 F.2d 642, the Court of Appeals acknowledged the formal interpretation of the Regulation in issue which the Federal Reserve Board had made a part of Regulation Z, 38 F.R. 23513, August 23, 1973, 12 C.F.R. §226.819. The Court also acknowledged as "entirely understandable" the lower courts' application of the interpretation to the Georgia loan fees in issue. 526 F.2d at 647. The Court of Appeals then looked to the language of the *preamble* to the interpretation, concluded that the

Board had reference only to a "*typical* add-on charge", 526 F.2d at 647, and apparently concluded that the Georgia loan fees were not "typical". *But see Kaufman, Bringing Chaos Out of Order: Truth in Lending in the Courts*, 10 GA. L. REV. 937, 938-939 and notes, which addresses this and other aspects of the first decision below.

By concluding that the Board's interpretation of the regulation in issue did not apply to the loan fees involved here, the Court below avoided the mandate of this Court set forth in the decisions noted above. Thus unencumbered the Circuit Court's tortured logic concluded that the Georgia loan fees which though "earned" at the time the loan was made, but were paid in installments over the life of the loan, were nevertheless "prepaid finance charges" and must be disclosed as such. Although the Court recognized that the loan fees were added to the amount financed to be repaid, or collected, over the life of a loan, it concluded that "[*d*]*eferring collection* of the loan fee by adding it on to the other amounts financed does not change its character as a *prepaid* fee." 526 F.2d at 647 (emphasis added). Thus, the Court found that the fees in issue were "collected" at the time the loan was made even though they were not collected at the time the loan was made. In this manner the court concluded that even though the loan fees were not paid at the time the loan was made, they were nevertheless "paid" at the time the loan was made and were thus "prepaid".

When subsequently made aware that the Federal Reserve Board had expressly considered the Georgia precomputed add-on loan fees when it published its

interpretation of Regulation Z §226.8 on August 23, 1973, the Circuit Court invited the Board to file an *amicus curiae* brief. (*See* Appendices F & G) The Board filed a brief *amicus curiae*, pointing out that the concept of a "prepaid finance charge" does not appear anywhere in the Truth-in-Lending Act (Brief of Board of Governors, Appendix H p.11h), and unequivocally stating that the Board's interpretation 12 C.F.R. §226.819 was intended to apply to precomputed finance charges such as the Georgia loan fee, and that the Board specifically had the Georgia loan fee in mind in drafting and adopting the interpretation (Brief of Board of Governors, Appendix H, p. 20h).

Confronted with an agency's formal expression of intent with respect to the purpose and effect of an interpretation of an administrative regulation promulgated by the agency interpreting it, the Court of Appeals was required to decide the issue in accordance with the decisions of this Court requiring that great weight be given such interpretations. Nevertheless, on rehearing, the Court of Appeals refused to follow the agency's interpretation even though it did not find the interpretation plainly erroneous or inconsistent with the regulation. 544 F.2d 1228. Thus, the case below was decided in a way in conflict with applicable decisions of this Court.

The Court below declared the Board's interpretation "meaningless" and "contrary to the statutory scheme." 544 F.2d 1232. Yet the manner in which the interpretation is contrary to the statute is never expressed by the Court. Indeed, the facts that the concept of "prepaid finance charge" does not appear

in the Act and that the regulation involved was a creature of the Board itself are totally ignored by the Court of Appeals.

The Court below conceded that the words of the regulation promulgated by the Board "are certainly susceptible of the construction placed on them by the Board." 544 F.2d 1232. Yet the Court below ignored the requirement that:

> ". . . where reasonable minds may differ as to which of several remedial measures should be chosen, courts should defer to the informed experience and judgment of the agency to whom Congress delegated appropriate authority." *Mourning v. Family Publications Service Inc.*, 411 U.S. 356, 371-72, 93 S.Ct. 1652, 1662 (1973).

The Court of Appeals admitted that reasonable minds may differ on the meaning of the disclosure requirement yet in the same opinion refused to defer to the informed experience and judgment of the agency which promulgated the requirement, expressed unequivocally in an *amicus curiae* brief.

Contrary to the decisions of this Court, the Court of Appeals has taken to itself the responsibility of promulgating regulations which Congress delegated to the Board, and has substituted its own discretion for that of the Board. Flying in the teeth of the decisions of this Court, the Circuit Court has determined that ". . . the interest-on-interest element of the Georgia loan fee arrangement . . . deserved . . . to receive separate disclosure status as a prepaid finance charge to separate it from other finance

charges . . . ." Footnote 5, 544 F.2d 1231. Petitioner submits that this expression makes it apparent that the panel which decided the case below was not satisfied with the Federal Reserve Board's decision not to require separate disclosure status as to the Georgia loan fee, and substituted its own view.

In addition to refusing to follow the Federal Reserve Board's interpretation of its own regulation, the Circuit Court of Appeals held that in any event the loan in issue here was made prior to the publication of the interpretation, and consistently refers to the interpretation as an "amendment". While it is true that the interpretation "amends" 12 C.F.R. 226.8 by adding 226.819, it is clear both from the language of the interpretation itself and the *amicus curiae* brief of the Board that the interpretation is merely explanatory of the meaning and intent of the original regulation and was not intended to effect any change in the original regulation.

In its brief, the Board recognized that the concept did not lend itself to a succinct description and that confusion over the application of the original regulation developed. It was in response to that confusion that the Board decided to take "some formal action to clarify this issue so as to avoid unnecessary and confusion-causing litigation." (Brief of Federal Reserve Board, p. 11.) The Board further points out that "this interpretation" adopts the position previously taken in staff opinion letters which were issued prior to the formal adoption of the interpretation and its publication in the Code of Federal Regulations.[2] Simply referring to the interpretation

2 Public Information Letter dated January 18, 1972, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶30,794; See also Letter 379, July 29, 1970, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶30,560; Letter 397, August 7, 1970, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶30,581. Appendix E pp. 13e-15e. Compare the treatment given these Staff Opinion letters by the Court below, 544 F.2d at 1232, with the Fifth Circuit decision in *Philbeck v. Timmers Chevrolet, Inc.*, 499 F.2d 971, 976-7 (1974), and cases of this Court there cited.

as an "amendment" does not change its character, nor justify the refusal of the Court below to follow the interpretation or ignore the staff opinion letters.

CONCLUSION

The Agency charged by Congress with the responsibility of promulgating regulations to effectuate the Truth-in-Lending Act has addressed the "prepaid finance charge" issue on six separate occasions. The issue was first addressed when the original regulation was promulgated; the concept does not appear in the Act itself. Thereafter, three separate staff opinion letters were issued. The Board for the fifth time addressed the issue and with the Georgia loan fees specifically in mind issued its formal interpretation of August 23, 1973, which was published as a part of the regulations themselves. Finally, for the sixth time and at the invitation of the Court of Appeals, the Board filed a formal *amicus curiae* brief addressed to the Court's first opinion in this case.

Yet in the face of these six consistent expressions by the Board, the Court of Appeals for the Fifth Circuit has refused to follow the Board's interpretation and has assumed the responsibility for deciding what

aspects of a loan transaction "deserved . . . separate disclosure status as a prepaid finance charge." In so doing the Court below has decided this matter of Federal law in a way in conflict with applicable decisions of this Honorable Court and Petitioner respectfully prays that a Writ of Certiorari be issued in this cause.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have made service of the foregoing Brief by depositing a copy of same in the United States Mail with sufficient postage affixed thereto, addressed to Respondent's attorney as follows:

David G. Crockett
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Suite 1245, Tower Place
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This 4 day of April, 1977.

F. CARLTON KING, JR.
Attorney for Petitioner

APPENDICES

APPENDIX A

ROSE E. JONES,
Plaintiff-Appellant,

v.

COMMUNITY LOAN & INVESTMENT CORPORATION OF FULTON COUNTY,
Defendant-Appellee.

HOMER LEE SLATTER,
Plaintiff-Appellant,

v.

AETNA FINANCE COMPANY,
Defendant-Appellee.

DEALEANER HAMMOND,
Plaintiff-Appellant,

v.

PUBLIC FINANCE CORPORATION,
Defendant-Appellee.

Nos. 74-3586, 74-3975, 74-4183.

United States Court of Appeals,
Fifth Circuit

Dec. 13, 1976.

Appeals from the United States District Court for the Northern District of Georgia.

ON PETITION FOR REHEARING

(Opinion Jan. 30, 1976, 5th Cir. 1976, 526 F.2d 642)

Before TUTTLE, THORNBERRY* and CLARK, Circuit Judges.

CLARK, Circuit Judge:

Our opinion issued January 30, 1976, 526 F.2d 642,[1] interpreted the Consumer Credit Protection Act[2] and the Federal Reserve Board's implementing Truth-in-Lending Regulation,[3] as that regulation was amended by 12 C.F.R. § 226.819 (Aug. 31, 1973).[4] We concluded that the Act and Regulation

*Judge Thornberry was a member of the panel in our opinion of January 30, 1976, but due to illness did not participate in this petition for rehearing. The case is decided by a quorum. 28 U.S.C. § 46(d).

[1] Our ruling on this petition for rehearing has been delayed by the illness of one counsel and of one of the members of the court, as well as by the press of other court business.

[2] 15 U.S.C. §§ 1601 *et seq.*

[3] Federal Reserve Board, Truth in Lending Regulations (Regulation Z), 12 C.F.R. §§ 226.1 *et seq.* (1969).

[4] *Id. as amended,* § 226.819 (Aug. 31, 1973). The amendment provides:

Add-on and Discount Finance Charges as Prepaid Finance Charges

This interpretation intends to make [clear] that the typical "add-on" or "discount" charge or other precomputed finance charge on an instalment contract or other obligation need not be labeled a "prepaid" finance charge.

as amended required the defendant Georgia lenders, who charged plaintiff borrowers a statutory nonrefundable fee for making their loans, to disclose that fee as a "prepaid finance charge." Subsequent to the publication of our decision, counsel for the Federal Reserve Board advised defendants that the interpretative regulation was intended to effect a contrary result. At the direction of the court the Board in an amicus curiae brief formally took the same position in this proceeding. In light of this unusual, if not unique, administrative and procedural posture, we have determined to grant defendants' petitions for rehearing and review our holding.

Part 226 of Title 12 is amended by adding the following section.

§ 226.819. *Prepaid finance charges; add-ons and discounts.*

(a) Section 226.8(c)(6), 226.8(d)(2) and 226.8(e)(1) require that certain finance charges be disclosed as "prepaid finance charges." They also require that such prepaid finance charges be excluded or deducted from the credit extended in arriving at the "amount financed." The question arises whether add-on, discount or other precomputed finance charges which are reflected in the face amount of the debt instrument as part of the customer's obligation, but which are excluded from the "amount financed," must be labeled as "prepaid" finance charges.

(b) The concept of prepaid finance charges was adopted to insure that the "amount financed" reflected only that credit of which the customer had the actual use. Precomputed finance charges which are included in the face amount of the obligation are not the type contemplated by the "prepaid" finance charge disclosure concept. Although such precomputed finance charges are not to be included in the "amount financed," they need not be regarded as finance charges "paid separately" or "withheld by the creditor from the proceeds of the credit extended" within the meaning of § 226.8(e) to require labeling "prepaid" under §§ 226.8(c)(6) and 226.8(d)(2). They are "finance charges", of course, to be disclosed under §§ 226.8(c)(8) and 226.8(d)(3).

[1] Because the three loans involved in this appeal were made to three separate borrowers by three separate lenders at three separate times, consideration must be given to this chronology of events:

May 30, 1972. Community Loan & Investment Corporation made its loan to Rose E. Jones.

November 3, 1972. The United States District Court for the Northern District of Georgia decided *Grubb v. Oliver Enterprises, Inc.*, 358 F.Supp. 970, which held that the Georgia loan fees under Ga. Code Ann. § 25-315(a), (b), must be disclosed as a "prepaid finance charge."

January 29, 1973. Public Finance Corporation made its loan to Dealeaner Hammond.

August 31, 1973. The Federal Reserve Board issued its interpretive amendment 12 C.F.R. § 226.819.

September 5, 1973. Aetna Finance Company made its loan to Homer Lee Slatter.

As to Rose E. Jones and Dealeaner Hammond it is immaterial that the Board, after these loans, adopted an amendment which it interprets to have an effect different from that we assigned in our opinion. Therefore, the opinion previously announced continues to require that each of these cases be reversed and remanded for further proceedings not inconsistent with that opinion.

The loan from Aetna Finance Company (Aetna) to Homer Lee Slatter, on the other hand, was made subsequent to the amendment which the Board declares was intended to exempt this type of prepaid loan fee from disclosure as a "prepaid finance

charge." In Slatter's case, this circumstance creates an issue of fact which the district court must resolve. Depending upon its resolution, Aetna may have a defense under the Act.

The Board's amicus curiae brief concedes that there is no doubt that the Georgia loan fee is a part of the "finance charge" referred to in the Act and its implementing Truth-in-Lending Regulation. It asserts that the Board's *sole* purpose in requiring the additional disclosure of a "prepaid finance charge" was to assure that any part of the finance charge which served to reduce the amount of the loan proceeds actually received by the debtor would result in a reduction of the "amount financed" so as to prevent understatement of the "annual percentage rate."

This court previously concluded that requiring the disclosure of a "prepaid finance charge" in addition to the already required disclosure of the "finance charge" could only serve the purposes of (1) informing the borrower that a charge made for an item such as a loan fee would not be returned even if the loan was paid off prior to maturity, and (2) informing the borrower that he was being charged an item of expense labeled "finance charge" but which was being treated as a part of the amount financed and which would bear interest just as the loan proceeds and other portions of the amount financed.[5]

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[5] In each instance the Georgia loan fee was included in the total amount of the note upon which the lenders charged statutory interest. This interest-on-interest element of the Georgia loan fee arrangement, Ga.Code Ann. § 25-315(a), (b) (1976), we concluded, deserved and must have been

[2, 3] Limiting the concept of "prepaid finance charge" as the Board now asserts it intended, renders the requirement totally meaningless. Its amicus brief admits that any such loan fee must always be a part of the "finance charge." The Consumer Credit Protection Act does not permit any part of the "finance charge" to be included as part of the amount financed. 15 U.S.C. § 1639(a)(1-3). The Truth-in-Lending Regulation is expressly to the same effect. 12 C.F.R. § 226.8(d)(1) (1969). Thus, the requirement of a separate disclosure of some finance charges as "prepaid" solely to prevent the inclusion of such charges in the amount financed is redundant and confusing. The law and the regulation already forbid this practice. Indeed, the requirement of adding a meaningless class of information to an already complicated set of words and figures thwarts rather than implements the Act's requirement of meaningful disclosure.

15 U.S.C. § 1640(f) provides:

> No provision of this section or [15 U.S.C. § 1611] imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board, notwithstanding that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

Notwithstanding that the Board's construction rend-

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intended to receive separate disclosure status as a prepaid finance charge to separate it from other finance charges which did not have this compound effect.

ers its requirement to disclose "prepaid finance charges" meaningless, it is the Board's construction, and the words used are certainly susceptible of the construction placed upon them by the Board. If Aetna cast its disclosure to Slatter in good faith to conform its practices with the Board's interpretation of its amendment, Aetna is free from liability under Section 1640(f). Our judicial declaration that the Board's interpretation is meaningless, and in fact contrary to the statutory scheme, does not change this. *See Ives v. W. T. Grant Co.*, 522 F.2d 749, 758-59 (2d Cir. 1975). While Aetna did not plead the defense permitted by Section 1640(f), it did not waive its rights now to urge this position because the statute was not enacted until October 28, 1974, which was subsequent to the responsive pleading in this case, and Congress has determined that Section 1640(f) shall be available here on appeal. Amendments to the Truth-in-Lending Act, Pub.L. No. 93-495, § 408(e) (amending 15 U.S.C. § 1640), *reprinted in* [1974] U.S.Code Cong. & Ad.News pp. 1744, 1746.

[4] We are pointed to three letters written by staff members of the Federal Reserve Board, published in a reporting service,[6] which are claimed to have warranted the practice Aetna followed here even before 12 C.F.R. § 226.819 (1973) was issued. Such letters, however, are not rules, regulations, or interpretations within the meaning of Section 1640(f), *Pennino v. Morris Kirschman & Co.*, 526 F.2d 367, 371 n.8 (5th Cir. 1976), and cannot form the

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[6] The three staff letters upon which the defendants claim to rely may be found at [1970] 5 Cons.Cred.Guide (CCH) ¶¶30560, 30581; [1972] *id.* ¶30794.

basis for claiming the statutory defense. As our prior opinion and *Grubb* made clear, both the Consumer Credit Protection Act and the Truth-in-Lending Regulation required that the Georgia loan fee be disclosed as a "prepaid finance charge." Thus, prior to the Board's promulgation of 12 C.F.R. § 226.819 (1973), omission of this disclosure was inconsistent with both law and regulation.

[5] A fact question remains which the district court should resolve: Did Aetna in good faith conform its practice to that contemplated under 12 C.F.R. § 226.819 (1973) issued 6 days previous to its loan to Slatter or did it not disclose the amount of the Georgia loan fees to Slatter because it simply continued to follow a prior improper practice? In resolving this question, evidence of Aetna's prior practice as well as any memoranda or instructions implementing a change conforming to 12 C.F.R. § 226.819 (1973) could be pertinent. We do not intend to limit the district court's inquiry to the two factors stated, nor do we intimate any view as to how the issue should be determined.

If the district court finds that Aetna conformed its practice to the amendment, then Aetna is entitled to the exemption from liability provided by Section 1640(f). If the district court so finds, it shall certify the findings and conclusions supporting such decision to this court to permit the resolution of the remaining issues raised in this present appeal which this panel now pretermits. If, on the contrary, the district court determines the statute is not applicable to the Aetna loan to Slatter, the judgment appealed from will stand reversed, and the district court

should proceed to finalize Slatter's litigation in the same manner as provided for the Jones and Hammond cases. This court does not retain jurisdiction.

The Judgments appealed from in Jones (Cause No. 74-3586) and in Hammond (Cause No. 74-4183) are REVERSED AND REMANDED.

The appeal in Slatter (Cause No. 74-3975) is REMANDED WITH DIRECTIONS.

APPENDIX B

ROSE E. JONES, *Plaintiff-Appellant,*

v.

COMMUNITY LOAN & INVESTMENT CORPORATION OF FULTON COUNTY, *Defendant-Appellee.*

HOMER LEE SLATTER,
Plaintiff-Appellant,

v.

AETNA FINANCE COMPANY,
Defendant-Appellee.

DELEANER HAMMOND,
Plaintiff-Appellant,

v.

PUBLIC FINANCE CORPORATION,
Defendant-Appellee.

Nos. 74-3586, 74-3975, 74-4183.

United States Court of Appeals,
Fifth Circuit.

Jan. 30, 1976.

Appeal from the United States District Court for the Northern District of Georgia.

Before TUTTLE, THORNBERRY and CLARK, Circuit Judges.

CLARK, Circuit Judge:

The appeals in these consolidated Regulation Z Truth-in-Lending cases turn on whether the statutory loan fees imposed pursuant to Georgia law were required to be disclosed as "prepaid finance charges." To resolve the issue we must harmonize the federal statutory scheme, its implementing regulations and the applicable Georgia statutes. Because these loan fees were fully earned at the time the loans were made, Regulation Z required that they be disclosed as "prepaid" to meaningfully inform the borrower of the prepaid nature of such fees. This is true despite the fact that the loan companies effected the collection of such fees by adding them to the other amounts of credit extended and allowed repayment to be made over the life of the loan. The judgments appealed from which approved notes that failed to disclose the "prepaid" status of such loan fees are reversed.

The instant actions seeking statutory damages, costs and attorneys' fees were brought under the Consumer Credit Protection Act, 15 U.S.C. §1640. Each action alleges various violations of the Act in connection with its subject loan. One assertion common to all causes is the contention that the loan or service fees charged under Georgia law were required by Regulation Z, 12 C.F.R. Part 226, to be

labeled as a "prepaid finance charge" and that for lack of proper labeling the lenders are liable to the borrowers for the Act's statutory damages. Our view that the contention is correct makes the issue dispositive in all appeals.

Regulation Z defines "credit" as the right granted by a lender to a customer to defer payment of debt, or to incur debt and defer its payment. 12 C.F.R. §226.2(*l*). In the case of loans such as the ones involved in the instant actions, Regulation Z requires that any penalty charge for prepayment be described. 12 C.F.R. §226.8(b)(6). In addition, it requires disclosure of the amount of credit which will be paid to the customer, or for his account to another person, under the term "amount financed." This latter requirement is subject to an express proviso which is the fulcrum of the present appeals. It mandates that "Any finance charge paid separately, in cash or otherwise, directly or indirectly to the creditor . . . or withheld by the creditor from the proceeds of the credit extended" shall be excluded from the "amount financed" and disclosed as a "prepaid finance charge." 12 C.F.R. §226.8(d) and (e)(1).[1]

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[1] (d) *Loans and other nonsale credit.* In the case of a loan or extension of credit which is not a credit sale, in addition to the items required to be disclosed under paragraph (b) of this section, the following items, as applicable, shall be disclosed:

(1) The amount of credit, excluding items set forth in paragraph (e) of this section, which will be paid to the customer or for his account or to another person on his behalf, including all charges, individually itemized, which are included in the amount of credit extended but which are not part of the finance charge, using the term "amount financed."

(2) Any amount referred to in paragraph (e) of this section required to be excluded from the amount in sub-

On August 31, 1973, the Board issued an interpretative amendment to Regulation Z to make it clear "that the *typical* 'add-on' or 'discount' charge or other precomputed finance charge . . . need not be labeled a 'prepaid' finance charge." (emphasis added). In essence, this interpretative amendment advised that "add-on, discount or other precomputed finance charges which are reflected in the face amount of the debt instrument as part of the customer's obligation" should be excluded from the "amount financed" and did not require labeling as "prepaid." The Board's amendatory language reasoned: "The concept of prepaid finance charges was adopted to insure that the 'amount financed' reflected only that credit of which the customer had

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paragraph (1) of this paragraph, using, as applicable, the terms "prepaid finance charge" and "required deposit balance," and, if both are applicable, the total of such items using the term, "total prepaid finance charge and required deposit balance."

(3) Except in the case of a loan secured by a first lien or equivalent security interest on a dwelling and made to finance the purchase of that dwelling, the total amount of the finance charge,[11] with description of each amount included, using the term "finance charge."

(e) *Finance charge payable separately or withheld; required deposit balances.* The following amounts shall be disclosed and deducted in a credit sale in accordance with paragraph (c) (6) of this section, and in other extensions of credit shall be excluded from the amount disclosed under paragraph (d) (1) of this section, and shall be disclosed in accordance with paragraph (d) (2) of this section:

(1) Any finance charge paid separately, in cash or otherwise, directly or indirectly to the creditor or with the creditor's knowledge to another person, or withheld by the creditor from the proceeds of the credit extended.[12]

[12] Finance charges deducted or excluded as provided by this paragraph shall, nevertheless, be included in determining the finance charge under § 226.4.

the actual use." 38 Fed.Reg. 23513.[2]

Against this background of federal statute and regulation, we consider the details of the Georgia loans involved in the instant actions. The plaintiff individuals in each of the consolidated cases borrowed money from different finance companies. The defendant lenders charged the borrowers the maximum 8% per annum rate of interest permitted by

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[2] PART 226—TRUTH IN LENDING
Add-on and Discount Finance Charges as Prepaid Finance Charges

This interpretation intends to make [clear] that the typical "add-on" or "discount" charge or other precomputed finance charge on an instalment contract or other obligation need not be labeled a "prepaid" finance charge.

Part 226 of Title 12 is amended by adding the following section.

§ 226.819 *Prepaid finance charges; add-ons and discounts.*

(a) Section 226.8(c) (6), 226.8(d) (2) and 226.8(e) (1) require that certain finance charges be disclosed as "prepaid finance charges." They also require that such prepaid finance charges be excluded or deducted from the credit extended in arriving at the "amount financed." The question arises whether add-on, discount or other precomputed finance charges which are reflected in the face amount of the debt instrument as part of excluded from the "amount financed", must be labeled as "prepaid" finance charges.

(b) The concept of prepaid finance charges was adopted to insure that the "amount financed" reflected only that credit of which the customer had the actual use. Precomputed finance charges which are included in the face amount of the obligation are not the type contemplated by the "prepaid" finance charge disclosure concept. Although such precomputed finance charges are not to be included in the "amount financed," they need not be regarded as finance charges "paid separately" or "withheld by the creditor from the proceeds of the credit extended" within the meaning of § 226.8(e) to require labeling "prepaid" under §§ 226.8(c) (6) and 226.8(d) (2). They are "finance charges", of course, to be disclosed under §§ 226.8(c) (8) and 226.8(d) (3).

Georgia law and also charged the maximum "Fee for making loan" permitted by Georgia law. Ga.Code Ann., §25-315(a) and (b).[3] The Lenders did not label

[3] 25-315. Maximum rate of charge.—Every licensee hereunder may loan any sum of money not exceeding $2,500 for a period of two years or less, and may charge, contract for, collect and receive interest and fees, and may require the fulfillment of conditions on such loans as hereinafter provided:

(a) Basic interest; advance discounts.—Charge, contract for, receive and collect interest at a rate not to exceed eight per cent. per annum of the face amount of the contract, whether repayable in one single payment or repayable in monthly or other periodic installments. On loan contracts repayable in 18 months or less, the interest may be discounted in advance, and on contracts repayable over a greater period, the interest shall be added to the principal amount of the loan. On all contracts, interest or discount shall be computed proportionately on equal calendar months.

(b) Fee for making loan.—In addition thereto, charge, contract for, receive, or collect at the time the loan is made, a fee in an amount not greater than eight per cent. of the first $600 of the face amount of the contract, plus for per cent. of the excess: Provided, however, that such fee shall not be carried or collected on that part of a loan which is used to pay or apply on a prior loan, or installment of a prior loan from the same licensee to the same borrower made within the immediately preceding six months period: Provided, however, if the loan balance is $100 or less, the said period shall be two months, not six months: Provided, further, that nothing contained in subsections (a) and (b) of this section shall be construed to permit charges, interest or fees of any nature whatsoever in the aggregate in excess of the charges, interest and fees which would constitute a violation of section 57-117 and the repeals hereinafter set forth in this Chapter shall in no wise affect section 57-117 and section 57-9901. If a borrower prepays his entire loan to a licensee and within the following 15 days makes a new loan with that licensee (and if this is done within the six-month period or the two-month period above described, as may be applicable), the fee may be charged only on the excess by which the face amount of the new contract exceeds the amount which the borrower repaid to that licensee within the said 15-day period.

this loan fee as a "prepaid finance charge." It was not included in the "amount financed" total shown on the face of the note. However, the fee was included in the total amount on which the maximum statutory interest charge was computed. The loan fee, the interest so calculated, and the "amount financed" were then totaled and divided into equal installments payable over the life of the loan. Each note contained different prepayment provisions,[4] but none provided for the refund of any part of the loan or service fee except as absolutely necessary to avoid the usury provision of Georgia law.[5]

[4] The Jones note provided:

On prepayment of the obligation, any unearned portion of the interest shall be refunded using the Sum of the Digits Rule. The fee is not refundable, however, creditor shall not receive charges in excess of 5% per month and any such excess charges accruing upon prepayment shall be refunded.

The Slatter note provided:

In the event of prepayment in full prior to maturity a refund of that portion of the Finance Charge, designated above as Interest Charges, will be made according to the Rule of 78ths. Loan fees are not subject to refund except that in no event will the Lender retain from the interest charges and fees combined, a rate greater than 5% per month. No refund of under $1.00 will be made.

The Hammond note provided:

PREPAYMENTS: Refunds for prepayment are computed by the sum of the digits method (Rule of 78) on originally scheduled regular charge. Refunds of less than $1.00 are not made.

Georgia law provides a specific refund system upon prepayment of loans. Ga.Code Ann. § 25-317. It applies to prepaid *interest* and insurance charges but makes no mention of the loan fee charge.

[5] 57-117. (3444, 3445) Rate greater than five per cent. per month prohibited.—No person, company, or corporation shall reserve, charge, or take for any loan or advance of

The definitive opinion by the district court on the proper classification of the Georgia loan fee was written in *Slatter v. Aetna Finance Co.*, 377 F.Supp. 806 (N.D.Ga. 1974).[6] There the court distinguished its prior holding in *Grubb v. Oliver Enterprises, Inc.*, 358 F.Supp. 970 (N.D.Ga.1972), which required the Georgia loan fee to be characterized as a "prepaid finance charge." The distinction was based upon what *Slatter* characterized as a difference in the method of fiscal disbursements and accounting followed in the two transactions. *Grubb* involved a $55.94 loan which was refinanced 4 months after it was made by a second loan of the same amount. The *Grubb* court stated that the loan fee there was collected at the time the loan was made and was not refundable except as required by statute in connection with a refinancing, and held such a fee had

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money, or forbearance to enforce the collection of any sum of money, any rate of interest greater than five per centum per month, either directly or indirectly, by way of commission for advances, discount, exchange, the purchase of salary or wages, by notarial or other fees, or by any contract, contrivance, or device whatever; save and except only that regularly licensed pawnbrokers, where personal property is taken into their actual physical possession and stored by them, may charge, in addition to said rate of interest, not exceeding 25 cents at the time said property is first taken possession of by them for the storage of said property. This section shall not be construed as repealing or impairing the usury laws now existing, but as being cumulative thereof.

[6] This issue was also discussed in other unreported cases. *See Howard v. Public Finance Corp.*, C.A. 17725 (N.D.Ga. Sept. 18, 1974); *Heard v. G. A. C. Finance Corp.*, C.A. 18117 (N.D.Ga. June 27, 1974); *McTerry v. Household Finance Corp.*, C.A. 18159 (N.D.Ga. June 21, 1974); and *Hamilton v. G. A. C. Finance Corp.*, C.A. 18163 (N.D.Ga. May 22, 1974).

to be labeled "prepaid" to comply with Regulation Z.[7] *Slatter* reasoned that *Grubb* involved a loan fee "actually withheld at the time of the consummation of the loan," whereas Slatter's loan fee had been added to the amount financed along with the interest charged to Slatter and the total had been divided by the number of monthly payments involved.[8] This, said the *Slatter* court, constituted the loan fee a charge in the nature of an add-on finance charge within the meaning of the Reserve Board's August 23, 1973 amendment.

The court in *Slatter* was persuaded that the difference in language used by the Georgia legislature in authorizing interest charges under §25-315(a) and in authorizing loan fees under §25-315(b)[9] was intended to extend to lenders an option of "receiving or collecting the loan fee 'at the time the loan is made' or of merely charging the loan fee at the time the loan is made and adding it to the principal amount for collection along with the loan payments." Its

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[7] *Grubb* was decided prior to the Board's August 23, 1973, interpretative ruling, thus its impact was not discussed.

[8] Of course we would not differ with the result *Slatter* conceded to be correct under the facts it supposed were before the *Grubb* court. If a lender required a customer to pay over the loan fee in cash at the time the loan was made, the necessity for "prepaid" classification is obvious. We would note, however, that nothing in the language of the *Grubb* opinion supports *Slatter's* distinction. We do not have Grubb's note in the record before us, and *Slatter* does not indicate that extra-opinion documentation was the basis for its view of that transaction. We have not pursued the matter because the accuracy of the distinction does not control the outcome of the appeal as we view the requirement of Regulation Z.

[9] See note 3, *supra*.

reasoning went that since the statute made it mandatory to use the add-on method of computing interest on loans for periods greater than 18 months and did not mandate any method for collection of the loan fee, the latter section was permissive. Thus, it read the language permitting a lender to "charge, contract for, receive or collect at the time the loan is made, a [loan] fee" as allowing the lender two alternatives. It could charge, contract for, or receive the loan fee in any manner it wished or it could collect the fee at the time the loan was made. Not only is this construction at odds with the catch line title of the loan fee paragraph, which is "FEE FOR *MAKING* LOAN," it stands the grammar used by the Georgia legislature on its head and fails to follow the construction placed on this part of the statute by the courts of Georgia.

Georgia courts have consistently refused to hold the maximum interest rate to be usurious where that interest rate was calculated on the total of all amounts financed plus a loan fee which had been added in with all other charges and disbursements and collected over the life of a loan. Georgia's reasoning was that the interest charge calculated in this fashion was not rendered usurious even where the loan fee was repaid in installments because the fee was due at the time the transaction originated and was a fee collected "for *making* the loan" (emphasis in the original). *Robbins v. Welfare Finance Corp.*, 95 Ga.App. 90, 96 S.E.2d 892, 896 (1957); *accord*, *McDonald v. G.A.C. Finance Corp.*, 115 Ga.App. 361, 154 S.E.2d 825 (1967).[10] This reasoning controls

[10] *E. g., Gentry v. Consolidated Credit Corp.*, 124 Ga.App. 597, 184 S.E.2d 692 (1971); *Robinson v. Colonial Discount Co.*, 106 Ga.App. 274, 126 S.E.2d 824 (1962): *Haire v. Allied Finance Co.*, 99 Ga.App. 649, 109 S.E.2d 291 (1959).

our decision. Deferring collection of the loan fee by adding it on to the other amounts financed does not change its character as a prepaid fee. Deferring collection of the credit does not cause the credit to be extended at a later date. Regulation Z defines credit as a right the lender grants to the borrower to incur an indebtedness for a loan fee or any other purpose and defer its repayment. The borrower has the use of this credit from the date the loan is made just as he has the actual or constructive use of funds advanced for insurance charges, recording fees and the like.

Slatter refused to give any weight to the fact that the loan fee was not refundable in the event of prepayment, reasoning that this was a circumstance which occurred *after* the credit had been extended and was controlled exclusively by the borrower. In light of the Regulation Z requirements that any penalty for prepayment must be described and loss of the loan fee was either not mentioned in these notes or was restricted only to the extent necessary to avoid usury,[11] *Slatter* cannot be squared with the letter or the spirit of meaningful, informed disclosure which the Act and Regulation Z sought to promote.

[1] There can be no doubt that the *Slatter* court placed great weight on its construction of the Board's 1973 amendment. It is entirely understandable that the court construed this action to give a finance

[11] See note 4, *supra*.

company the right to omit the "prepaid" characterization of the Georgia loan fee if it added the fee on with the add-on interest and collected it over the period of the loan. When the wording used in the amendatory language is read alone, it is susceptible to the misinterpretation that *any* finance charge which was added on to the face amount of the obligation and repaid in installments should not be classified as "prepaid." The problem of interpretation was doubtless compounded by the timing of the ruling, coming as it did after *Grubb* was decided. However, as the preamble to the amendment makes clear, the Board had reference only to the "*typical*" add-on charge. When the amendment is read in its total setting—the entire amendment, Regulation Z, the Act, and the Georgia laws which create and authorize the loan fee charge—it becomes apparent that the character of this credit cannot be made to depend upon the manner in which the lender may choose to treat it.[12]

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[12] We certainly intend no criticism of the district court's obvious effort to bring order from this veritable chaos of technical language. This court well recognizes the literal deluge of truth-in-lending cases which the bar of the district court has poured on judges already inundated by one of the heaviest docket loads in the circuit. Chief Judge Edenfield, in *Mullinax v. Willett Lincoln-Mercury, Inc.*, 381 F. Supp. 422 (N.D.Ga., 1974), observed:

> The number of truth in lending cases filed with this court is staggering. During the period of March 14, 1973 through July 31, 1974, some 725 truth in lending cases have been referred to the bankruptcy judges. During the same period 385 of these cases were finally disposed of by the referees, with almost no appeals and very few petitions for review. Truth in lending cases currently represent 28% of all cases being filed with this court. Handled by the judges as ordinary litigation, this simply would not have been possible.

(Footnotes omitted.)

The amendment says that "[t]he concept of prepaid finance charges was adopted to insure that the 'amount financed' reflected only that credit of which the customer had the actual use." Whether the borrower has actual use of credit does not hinge on whether it is disbursed to him. As Regulation Z makes it plain, credit has been extended if monies the borrower must repay have been "paid separately, in cash or otherwise, directly or indirectly to the creditor, . . . or withheld by the creditor from the proceeds of the credit extended." 12 C.F.R. §226.8 (b)(6) and (e)(1).

That the loan fee is to be paid by the borrower to the lender is not even open to question. *When* it is to be paid is the issue. Every documentary and financial fact indicates that the lender collects the loan fee at the time the credit is extended. As stated, the loan fee was not a refundable charge. *Robbins* and the other Georgia cases cited above make it plain that the fee is fully earned by the act of extending credit, and that if this were not so, the interest charge as calculated would be usurious. Interest at the maximum statutory rate can only be collected on the full amount of these loan fees in the same manner it was collected on every other part of the "amount financed" because the lender extended credit for this fee in advance. For all of these reasons, this loan fee was an integral part of "that credit of which the customer had the actual use" *at the time the note was signed.*

The loan fee was required by statute and regulation to be shown as a part of the finance charge, 15 U.S.C. §1605(a)(3), 12 C.F.R. §226.4(a)(3). But

showing it as a finance charge without more would be misleading. As a one-time expense due at the outset, the loan fee is different from a typical add-on charge which may later be recovered if not earned or expended with the passage of time over the life of the transaction. The necessity to make this difference plain to the borrower is precisely why Regulation Z requires that the customer be told that this segment of the finance charge is prepaid. If it is to be interpreted in a manner consistent with the Act's purpose, the amendment cannot be held to have changed this concept, and it did not do so. It must not be held to encompass charges which are in point of economic fact prepaid by credit extended at the outset of the transaction which, to enhance the lender's income or facilitate the transaction, is deferred in its repayment.

[2] The district court gave controlling weight to the fact that the lender dealt with the fee as an amount added on to the principal and collected in installments over the life of the loan. Such consideration misplaces the add-on form of repayment over the fee's substance as prepaid credit. The heart requirement of the Consumer Credit Protection Act is disclosure which is meaningful to the borrower. The obvious intent of requiring the labeling of an item as "prepaid" would be to inform the borrower that the charge indicated has already been paid out by him or for his account at the time of the extension of the credit and, as importantly, that it is a charge which will not be returned if the loan is paid off prior to maturity. In every one of these three cases (1) the Georgia loan fee was added to the other items composing the "amount financed" and the

lender calculated interest at the maximum statutory rate on the total of these two amounts, and (2) the loan fee was not described as a refundable item in the provision of the note related to calculating prepayment refunds.[13]

The failure to describe such a finance charge as "prepaid" in these loan instruments entitles plaintiff-appellants to relief under the Act. We need not and do not reach the remaining assignments of error. The several judgments appealed from are reversed and the causes remanded to the district court for further proceedings not inconsistent with this opinion.

Reversed and remanded.

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[13] Georgia law requires that proportional credit must be given if the note is a refinancing of a prior loan or if any new borrowing is made within 15 days of prepayment. See note 3, *supra*.

APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

ROSE E. JONES

vs.

COMMUNITY LOAN & INVESTMENT CORPORATION OF FULTON COUNTY

CIVIL ACTION NO. 18382

ORDER

This action is brought pursuant to the Truth-in-Lending provisions of the Federal Consumer Credit Protection Act, 15 U.S.C. §1601 *et seq.* and Regulation Z, promulgated pursuant thereto, to recover statutory damages, reasonable attorney's fees and costs. The case was referred to a Bankruptcy Judge, acting as Special Master, who denied plaintiff's motion for summary judgment and ordered that the complaint be dismissed. Plaintiff has filed objections to the Report of the Special Master as follows: (1) plaintiff objects to the reference of this matter to a Special Master; (2) plaintiff objects to the finding that the loan fee charged under the Georgia Industrial Loan Act was not a prepaid finance charge; (3) plaintiff objects to the Special Master's con-

clusion that defendant's use of the term "Sum of the Digits Rule" does not violate the Truth-in-Lending Act and to the finding that the insurance authorization involved in the instant case was adequate and that the defendant complied with the requirements of Regulation Z §226.4(a)(5) by disclosing the cost of the credit life and disability insurance and obtaining a dated and signed affirmative option to purchase that insurance; and (4) plaintiff objects to the Special Master's conclusions with regard to the disclosure of the term of insurance sold to plaintiff.

As to the first objection, this court has before it several cases raising the issue of the court's reference of the Truth-in-Lending cases to the Bankruptcy Judges as Special Masters. This question is now being considered in *Mullinax v. Willett Lincoln-Mercury*, Civil Action No. 19443 (N.D. Ga.). At this time that issue is pretermitted and counsel are invited to file amicus briefs on this issue in the *Mullinax* case.

Plaintiff's second objection is directed to the Special Master's conclusion that the loan fees charged by defendant in this case, pursuant to the Georgia Industrial Loan Act, need not be disclosed as a "prepaid finance charge." She relies on *Grubb v. Oliver Enterprises*, 358 F. Supp. 970 (N.D. Ga. 1972). For the reasons stated in *Heard v. G.A.C. Finance Corp.*, Civil Action No. 18117 (N.D. Ga., June 27, 1974) (O'Kelley, J.); and *Hamilton v. G.A.C. Finance Corp.*, Civil Action No. 18163 (N.D. Ga., May 22, 1974) (O'Kelley, J.), the court finds plaintiff's second objection to be without merit. *See also McTerry*

v. Household Finance Corp., Civil Action No. 18159 (N.D. Ga., June 21, 1974).

This court has held in several cases that reference to the rebate method as the "sum of the digits method" or the "Rule of 78's" was in compliance with the Truth-in-Lending Act and Regulation Z. *Hamilton v. G.A.C. Finance Corp., supra; Roberts v. National School of Radio & Television Broadcasting*, Civil Action No. 18742 (N.D. Ga., April 24, 1974) (Edenfield, J.). *See also* 12 CFR §226.818(c); *Bone v. Hibernia Bank*, 493 F.2d 135 (9th Cir. 1974), *rev'g* 354 F. Supp. 310 (N.D. Cal. 1972). For the reasons stated in the above-cited cases and in the opinion of the Special Master in this case, the court finds plaintiff's contention that defendant's use of the term "Sum of the Digits Rule" violates the Truth-in-Lending Act to be without merit.

In its objections to the Special Master's opinion, plaintiff contends that he erred in failing to find the insurance authorization utilized by defendant inadequate under the Act and in finding that the authorization complied with the requirements of Regulation Z §226.4(a)(5). A similar contention was made in plaintiff's motion for summary judgment. For the reasons stated in numbered paragraph (3) of the Report of the Special Master, we find compliance with the Act and Regulation Z.

Plaintiff's last objection to the findings and conclusion of the Special Master is an objection to his findings "with regard to the disclosure of the term of insurance sold to Plaintiff." This objection seems to object to numbered paragraph (4) and portions of numbered paragraph (5) of the Special Master's

Report.[1] Plaintiff's objection is solely based on *Philbeck v. Timmers Chevrolet Co.*, 361 F. Supp. 1255 (N.D. Ga. 1973).

As noted in the Report of the Special Master, the *Philbeck* court found a violation of Regulation Z because the lender had failed to make adequate disclosure of the term of the insurance coverage *on the face of the disclosure statement.* It specifically found that the language on the reverse side of the contract fully disclosed the term of coverage. *Id.* at 1259-60. In the instant case the disclosure statement shows that payments were to be made over a period of 24 consecutive months and that insurance, if obtained, would be obtained for "the term of the loan." The court agrees with the findings and conclusions of the Special Master that defendant complied with the Act and Regulation Z with respect to disclosure of the term of insurance procured. The FRB letter of October 26, 1973, No. 724 CCH Consumer Credit Guide ¶31,035 supports the Special Master's findings and conclusions. That letter was written in response to a request for the staff views on the meaning of Interpretation 226.402 of Regulation Z; specifically it was asked if it was the Board's intent by Interpretation 226.402 to require that the term of credit life insurance be shown in connection with the disclosures under §226.4(a)(5) when that insurance is written for the full term of the obligation. The letter states, in pertinent part:

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[1] Numbered paragraph (5) of the Report deals with the bona fide error defense pled by defendant; in part it also pertains to the adequacy of the disclosure of the term of insurance.

> We believe it was not the Board's intent to add a blanket requirement to either §226.4(a)(5) or (6) by interpretation 226.402 that in all cases in which the insurance cost is disclosed the term of the obligation must also be shown. *Specifically, in our opinion the term of the insurance coverage need not be shown where the coverage is for the full term of the obligation.* (Emphasis added.)

Accordingly, for the reasons hereinabove stated, at this time the issue of the court's reference of Truth-in-Lending cases to the Bankruptcy Judges as Special Master is pretermitted pending resolution of that issue in *Mullinax v. Willett Lincoln-Mercury*, Civil Action No. 19443 (N.D. Ga.). In all other respects, the recommendations of the Special Master are hereby approved and adopted.

IT IS SO ORDERED.

This, the 17 day of July, 1974.

/s/ RICHARD C. FREEMAN

RICHARD C. FREEMAN
United States District Judge

[Note to Court: For the text of the unreported opinions and recommendations of the Bankruptcy Judge sitting as Special Master in *Heard v. G.A.C. Finance Corporation, McTerry v. Household Finance Corp.*, and *Hamilton v. G.A.C. Finance Corporation*, see CCH Consumer Credit Guide ¶s 98,802; 98,803, 98,804. These opinions were affirmed in the unreported opinions of the District Court.]

APPENDIX D

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

ROSE E. JONES, *Plaintiff,* v. COMMUNITY LOAN & INVESTMENT CORPORATION OF FULTON COUNTY, *Defendant.*	CIVIL ACTION 18382 — REPORT OF SPECIAL MASTER

OPINION

Plaintiff brings this action under the Truth-in-Lending provisions of the Federal Consumer Credit Protection Act, 15 U.S.C. §1601, et seq., and Regulation Z, promulgated pursuant thereto, to recover statutory damages, reasonable attorneys' fees and costs of this action.

Plaintiff alleges four violations of the Act, (1) involving failure to disclose the loan fee as "prepaid finance charges," (2) involving alleged inadequate reference to the "sum-of-the-digits rule" as the method of rebate of finance charges in event of prepayment of loan, (3) involving alleged inadequate insurance authorization, and (4) involving alleged inadequate disclosure of the term of the credit life and accident & health insurance sold to plaintiff as a part of the transaction.

Having reviewed and carefully considered the pleadings, the exhibits, motion for summary judgment, responses and briefs presented to the Court, the Court finds the following:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

(1) *Prepaid Finance Charge*

Plaintiff contends that the loan fees charged by defendant in this case, pursuant to the Georgia Industrial Loan Act, must be disclosed using the term "prepaid finance charge" and cites as controlling authority the case of *Grubb v. Oliver Enterprises, d/b/a Dollar Loan Company*, 358 F. Supp. 970 (N. D. Ga. 1973). Defendant contends that *Grubb* is not applicable in the instant case because the loan fees charged here were added to the credit extended to determine the total of payments and, thus, were not withheld by the creditor from the proceeds of the credit extended as alleged by plaintiff.

The disclosure statement attached as Exhibit "A" to the complaint shows on its face that defendant is correct in this regard.[1]

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[1] The disclosure statement attached as Exhibit "A" to the Complaint, in pertinent part, shows the following:

ANNUAL PERCENTAGE RATE 21.91%

Credit Life Insurance	$52.80	Amount Financed		$1,061.13
Credit Disability Insurance	79.20	8% Fee	$48.00	
		4% Fee	28.80	
Recording Fee	2.50	Interest	82.07	
		Finance Charge		258.87
		Total of Payments		$1,320.00

24 Payments at $55.00 per month

The "amount financed", i.e., the "credit extended", is shown by the disclosure statement to be $1,061.13. The "finance charge", a combination of interest and service fees totaling $258.87, was clearly added to the credit extended to determine the "total of payments" in the amount of $1,320.00. That amount was then to be paid by the plaintiff in 24 equal monthly installments of $55.00 each.

This Court finds that in the instant case the precomputed loan fees were "added to" the amount financed to become part of the total of payments to be paid later to the creditor over the term of the credit extended, and for the reasons set forth in the Report of the Special Master in the case of *Blanche Hamilton v. G.A.C. Finance Corporation*, No. 18163, Northern District of Georgia, March 11, 1974, this Court holds that the loan fees in this case were not required to be disclosed and labeled as "prepaid finance charges". To same effect see: *McTerry v. Household Finance Corp.*, C.A. 18159 (U.S.D.C., N.D. Ga.) and *Heard v. G.A.C. Finance Corporation*, C.A. 18117 (U.S.D.C., N.D. Ga.).

(2) *Rebate of Interest via Sum-of-the-Digits Rule*

With respect to disclosure of the method for rebate of unearned charges in the event of a prepayment of the obligation, plaintiff asserts that defendant's use of the term "sum-of-the-digits rule" violates both the Act and Regulation Z. Plaintiff cites as authority the case of *Bone v. Hibernia Bank* (N.D. Cal. No. C-72794, December 15, 1972), and *Roberts v. National School of Radio and Television Broadcasting* (N.D. Ga. 1974, C.A. No. 18742), which applied the ruling in *Bone*.

The District Court in *Bone, supra*, held that a simple reference to the "rule of 78's" did not provide meaningful disclosures to the average credit customer. Plaintiff urges that same ruling here. However, for the reasons set forth in the Report of the Special Master in *Blanch Hamilton v. G.A.C. Finance Corporation* (N.D. Ga., C.A. No. 18163, dated February 26, 1974), this Court finds that defendant's use of the phrase "sum-of-the-digits rule" in the instant case was in compliance with Regulation Z. It is clear from authority cited in that opinion that "sum-of-the-digits" and "Rule of 78's" are synonymous and interchangeable terms referring to the same method of rebate of interest. See also Ga. Code Ann. § 96-1005. Moreover, the Ninth Circuit Court of Appeals, on March 4, 1974, reversed the said decision of the California District Court in the *Bone* case, *supra*. The Ninth Circuit Court also noted that the "sum-of-the-digits" and the Rule of 78's" are the same.

(3) *Inadequate Insurance Authorization*

Plaintiff claims that defendant has failed to obtain a proper insurance authorization for the insurance sold to plaintiff in that defendant failed to afford the plaintiff an option to buy disability insurance alone. Admittedly, the disclosure statement attached as Exhibit "A" to the Complaint provides only three options: (1) purchase of credit life insurance together with disability insurance; (2) credit life insurance only; and (3) neither credit life nor disability. However, the disclosure statement clearly states that credit life and disability insurance is not required to obtain the loan, the cost of credit life

insurance is clearly shown, as is the cost of disability insurance, and beneath that cost is a dated signature of the plaintiff authorizing the purchase of that insurance at that cost.

Plaintiff fails to cite any provision in either the Consumer Credit Protection Act or Regulation Z which is addressed to the options which a lender is required to give a borrower in connection with the purchase of credit life or disability insurance, and this Court knows of no such provision. The purpose of the Act and Regulation Z is to provide full disclosure to the borrower; neither the Act nor Regulation Z attempt to dictate to the lender the insurance options it must make available. Accordingly, this Court finds that the insurance authorization involved in the instant case was adequate and that defendant complied with the requirements of Regulation Z § 226.4(a)(5) by disclosing the cost of the credit life and disability insurance and obtaining a dated and signed affirmative option to purchase that insurance.

(4) *Adequate Disclosure of the Term of Insurance*

With respect to credit life and disability insurance sold in connection with the subject loan, the disclosure statement attached at Exhibit "A" to the Complaint states:

> "Such insurance will only be procured *for the term of the loan* if Customer(s) requests Creditor to obtain such insurance by signing below." (emphasis supplied)

Plaintiff contends that this disclosure is not a suffi-

cient disclosure of the term of the credit life and accident & health insurance sold to plaintiff, and relies solely on the case of *Philbeck v. Timmers Chevrolet, Inc.*, 361 F. Supp. 1255 (N.D. Ga. 1973). However, the language of disclosure in *Philbeck*, was held to fully disclose the term of insurance coverage, the violation of Regulation Z having been found to arise out of the failure of the lender to make disclosure on the face of the disclosure statement along with the other disclosure terms required by Regulation Z.

The above-quoted disclosure statement used by defendant here is located on the face of the disclosure statement attached as Exhibit "A" to the Complaint, along with the other items required to be disclosed by Regulation Z. Thus, *Philbeck v. Timmers Chevrolet, Inc.* is distinguishable from the instant case, and will not be applied here by this Court; nor does this Court express any opinion with respect to whether the holding in *Philbeck* is a correct interpretation of the Act and the Regulation. The disclosure statement involved here shows that payments were to be made over a period of 24 consecutive months and that insurance, if obtained, would be obtained for this *term of the loan*. Therefore, this Court finds that the term of insurance was disclosed by the defendant in compliance with the Act and Regulation Z.

Inasmuch as this Court finds that defendant complied with the Act and with Regulation Z with respect to both disclosure of the term of insurance procured and with respect to the obtaining of a valid authorization for the purchase of that insurance, it was not necessary for the charges for insurance to

be included in the finance charge, and plaintiff's argument that the finance charge and annual percentage rate were understated, therefore, fails.

(5) *Bona Fide Error Defense*

The disclosure statement here in issue discloses the term of insurance procured by stating that it will be "procured for the term of the loan". The sample form published by the Board of Governors of the Federal Reserve System in the pamphlet "What You Ought To Know About Federal Reserve Regulation Z" (Exhibit "E", page 26), discloses the term of insurance as follows:

> "If borrower desires property insurance to be obtained through the creditor, the cost will be $———— for the term of the credit."

This Court finds that the phrase "term of the loan" and the phrase "term of the credit" are in practical terms identical.

While it is recognized that, when specific words, phrases or terminology are stated in the Regulation, then those particular words, phrases, or terminology must be used to comply with the requirements of the Regulation, this Court finds that when the language of disclosure is not specifically set forth in the Regulation, and when the language of disclosure used is identical to or substantially the same as the language of disclosure contained in the aforementioned pamphlet, such circumstances present prima facie evidence in support of the bona fide error defense made available by the Act and pled by the defendant here. *See, also, Welmaker v. W. T. Grant Company* (N.D.

Ga. C.A. No. 15621, 1973); *Hamilton, supra*, page 70-72 (Division (2) (I), Good Faith Defense).

Further, this Court notes that the insurance options, as well as the manner in which they are disclosed on the disclosure statement at issue here, are identical to the options and disclosures found on the aforementioned sample form published by the Board of Governors of the Federal Reserve System in the aforementioned pamphlet. This fact is also considered by this Court to present prima facie evidence in support of the bona fide error pled by defendant.

This Court holds that the bona fide error defense pled by defendant, and the prima facie evidence in support thereof, would raise a material issue of fact which would necessitate the denial of plaintiff's motion for summary judgment. However, inasmuch as this Court has considered each of the violations alleged by plaintiff and has found as a matter of law that the defendant has complied with Regulation Z with respect to each, it is on that ground that plaintiff's motion for summary judgment is hereby denied, and the complaint is ordered dismissed, with each party bearing its own costs.

This 17th day of March, 1974.

s / William L. Norton, Jr.

WILLIAM L. NORTON, JR.
U.S. BANKRUPTCY JUDGE
SITTING AS SPECIAL
MASTER

APPENDIX E

STATUTES

CONSUMER CREDIT PROTECTION ACT
TITLE I—CONSUMER CREDIT COST

§ 103. Definitions and rules of construction

(b) The term "Board" refers to the Board of Governors of the Federal Reserve System.

§ 105. Regulations

The Board shall prescribe regulations to carry out the purposes of this title. These regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

§ 106. Determination of finance charge

(a) Except as otherwise provided in this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit, including any of the following types of charges which are applicable:

(1) Interest, time price differential, and any

amount payable under a point, discount, or other system of additional charges.

(2) Service or carrying charge.

(3) Loan fee, finder's fee, or similar charge.

(4) Fee for an investigation or credit report.

(5) Premium or other charge for any guarantee or insurance protecting the creditor against the obligor's default or other credit loss.

(b) Charges or premiums for credit life, accident, or health insurance written in connection with any consumer credit transaction shall be included in the finance charge unless

(1) the coverage of the debtor by the insurance is not a factor in the approval by the creditor of the extension of credit, and this fact is clearly disclosed in writing to the person applying for or obtaining the extension of credit; and

(2) in order to obtain the insurance in connection with the extension of credit, the person to whom the credit is extended must give specific affirmative written indication of his desire to do so after written disclosure to him of the cost thereof.

(c) Charges or premiums for insurance, written in connection with any consumer credit transaction, against loss of or damage to property or against liability arising out of the ownership or use of property, shall be included in the finance charge unless a clear and specific statement in writing is furnished by the creditor to the person to whom the credit is extended, setting forth the cost of the insurance if obtained from or through the creditor, and stating that

the person to whom the credit is extended may choose the person through which the insurance is to be obtained.

(d) If any of the following items is itemized and disclosed in accordance with the regulations of the Board in connection with any transaction, then the creditor need not include that item in the computation of the finance charge with respect to that transaction:

(1) Fees and charges prescribed by law which actually are or will be paid to public officials for determining the existence of or for perfecting or releasing or satisfying any security related to the credit transaction.

(2) The premium payable for any insurance in lieu of perfecting any security interest otherwise required by the creditor in connection with the transaction, if the premium does not exceed the fees and charges described in paragraph (1) which would otherwise be payable.

(3) Taxes.

(4) Any other type of charge which is not for credit and the exclusion of which from the finance charge is approved by the Board by regulation.

(e) The following items, when charged in connection with any extension of credit secured by an interest in real property, shall not be included in the computation of the finance charge with respect to that transaction:

(1) Fees or premiums for title examination, title insurance, or similar purposes.

(2) Fees for preparation of a deed, settlement statement, or other documents.

(3) Escrows for future payments of taxes and insurance.

(4) Fees for notarizing deeds and other documents.

(5) Appraisal fees.

(6) Credit reports.

§ 121. General requirement of disclosure

(a) Each creditor shall disclose clearly and conspicuously, in accordance with the regulations of the Board, to each person to whom consumer credit is extended the information required under this chapter or chapter 4.

§ 122. Form of disclosure; additional information

(a) Regulations of the Board need not require that disclosures pursuant to this chapter or chapter 4 be made in the order set forth in this chapter or chapter 4, and may permit the use of terminology different from that employed in this chapter or chapter 4 if it conveys substantially the same meaning.

§ 129. Consumer loans not under open end credit plans

(a) Any creditor making a consumer loan or otherwise extending consumer credit in a transaction which is neither a consumer credit sale nor under an open end consumer credit plan shall disclose

** Amended 10/28/74.

each of the following items, to the extent applicable:

(1) The amount of credit of which the obligor will have the actual use, or which is or will be paid to him or for his account or to another person on his behalf.

(2) All charges, individually itemized, which are included in the amount of credit extended but which are not part of the finance charge.

(3) The total amount to be financed (the sum of the amounts referred to in paragraph (1) plus the amounts referred to in paragraph (2)).

(4) Except in the case of a loan secured by a first lien on a dwelling and made to finance the purchase of that dwelling, the amount of the finance charge.

(5) The finance charge expressed as an annual percentage rate except in the case of a finance charge

(A) which does not exceed $5 and is applicable to an extension of consumer credit not exceeding $75, or

(B) which does not exceed $7.50 and is applicable to an extension of consumer credit exceeding $75.

A creditor may not divide an extension of credit into two or more transactions to avoid the disclosure of an annual percentage rate pursuant to this paragraph.

(6) The number, amount, and the due dates or periods of payments scheduled to repay the indebtedness.

(7) The default, delinquency, or similar charges payable in the event of late payments.

(8) A description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

(b) Except as otherwise provided in this chapter, the disclosures required by subsection (a) shall be made before the credit is extended, and may be made by disclosing the information in the note or other evidence of indebtedness to be signed by the obligor.

(c) If a creditor receives a request for an extension of credit by mail or telephone without personal solicitation and the terms of financing, including the annual percentage rate for representative amounts of credit, are set forth in the creditor's printed material distributed to the public, or in the contract of loan or other printed material delivered to the obligor, then the disclosures required under subsection (a) may be made at any time not later than the date the first payment is due.

§ 130. Civil liability

*(a) Except as otherwise provided in this section, any creditor who fails to comply with any requirement imposed under this chapter or chapter 4 of this title with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A) in the case of an individual action twice the amount of any finance charge in connection with

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* Amended 10/28/74.

the transaction, except that the liability under this subparagraph shall not be less than $100 nor greater than $1,000; or

(B) in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery in such action shall not be more than the lesser of $100,000 or 1 per centum of the net worth of the creditor; and

(3) in the case of any successful action to inforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional.

*(b) A creditor has no liability under this section for any failure to comply with any requirement imposed under this chapter, if within fifteen days after discovering an error, and prior to the institution of an action under this section or the receipt of written notice of the error, the creditor notifies the person concerned of the error and makes whatever adjustments in the appropriate account are necessary to insure that the person will not be required to pay a

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* Amended 10/28/74.

finance charge in excess of the amount or percentage rate actually disclosed.

(d) Any action which may be brought under this section against the original creditor in any credit transaction involving a security interest in real property may be maintained against any subsequent assignee of the original creditor where the assignee, its subsidiaries, or affiliates were in a continuing business relationship with the original creditor either at the time the credit was extended or at the time of the assignment, unless the assignment was involuntary, or the assignee shows by a preponderance of evidence that it did not have reasonable grounds to believe that the original creditor was engaged in violations of this chapter, and that it maintained procedures reasonably adapted to apprise it of the existence of any such violations.

(e) Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation.

**(f) No provision of this section or section 112 imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board, notwithstanding that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

** Added 10/28/74.

REGULATIONS

REGULATION Z
12 C.F.R. 226

SECTION 226.4—DETERMINATION OF FINANCE CHARGE

(a) **General rule.** Except as otherwise provided in this section, the amount of the finance charge in connection with any transaction shall be determined as the sum of all charges, payable directly or indirectly by the customer, and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit, whether paid or payable by the customer, the seller, or any other person on behalf of the customer to the creditor or to a third party, including any of the following types of charges:

(1) Interest, time price differential, and any amount payable under a discount or other system of additional charges.

(2) Service, transaction, activity, or carrying charge.[2]

(3) Loan fee, points, finder's fee, or similar charge.

(4) Fee for an appraisal, investigation, or credit report.

(5) Charges or premiums for credit life, accident, health, or loss of income insurance, written in con-

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[2] These charges include any charges imposed by the creditor in connection with a checking account to the extent that such charges exceed any charges the customer is required to pay in connection with such an account when it is not being used to extend credit.

nection with[3] any credit transaction unless

(i) the insurance coverage is not required by the creditor and this fact is clearly and conspicuously disclosed in writing to the customer; and

(ii) any customer desiring such insurance coverage gives specifically dated and separately signed affirmative written indication of such desire after receiving written disclosure to him of the cost of such insurance.

(6) Charges or premiums for insurance, written in connection with[4] any credit transaction, against loss of or damage to property or against liability arising out of the ownership or use of property, unless a clear, conspicuous, and specific statement in writing is furnished by the creditor to the customer setting forth the cost of the insurance if obtained from or through the creditor and stating that the customer may choose the person through which the insurance is to be obtained.[5]

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[3] A policy of insurance owned by the customer, which is assigned to the creditor or otherwise made payable to the creditor to satisfy a requirement imposed by the creditor, is not insurance "written in connection with" a credit transaction if the policy was not purchased by the customer for the purpose of being used in connection with that extension of credit.

[4] A policy of insurance owned by the customer, which is assigned to the creditor or otherwise made payable to the creditor to satisfy a requirement imposed by the creditor, is not insurance "written in connection with" a credit transaction if the policy was not purchased by the customer for the purpose of being used in connection with that extension of credit.

[5] A creditor's reservation or exercise of the right to refuse to accept an insurer offered by the customer, for reasonable cause, does not require inclusion of the premium in the finance charge.

(7) Premium or other charge for any other guarantee or insurance protecting the creditor against the customer's default or other credit loss.

(8) Any charge imposed by a creditor upon another creditor for purchasing or accepting an obligation of a customer if the customer is required to pay any part of that charge in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation.

SECTION 226.8—CREDIT OTHER THAN OPEN END—SPECIFIC DISCLOSURES

(c) **Credit sales.** In the case of a credit sale, in addition to the items required to be disclosed under paragraph (b) of this section, the following items, as applicable, shall be disclosed:

(6) Any amounts required to be deducted under paragraph (e) of this section using, as applicable, the terms "prepaid finance charge" and "required deposit balance," and, if both are applicable, the total of such items using the term "total prepaid finance charge and required deposit balance."

(d) **Loans and other nonsale credit.** In the case of a loan or extension of credit which is not a credit sale, in addition to the items required to be disclosed under paragraph (b) of this section, the following items, as applicable, shall be disclosed:

(1) The amount of credit, excluding items set forth in paragraph (e) of this section, which will be paid to the customer or for his account or to another person on his behalf, including all charges, individually itemized, which are included in the amount of credit extended but which are not part of the finance charge, using the term "amount financed."

(2) Any amount referred to in paragraph (e) of this section required to be excluded from the amount in subparagraph (1) of this paragraph, using, as applicable, the terms "prepaid finance charge" and "required deposit balance," and, if both are applicable, the total of such items using the term "total prepaid finance charge and required deposit balance."

(3) Except in the case of a loan secured by a first lien or equivalent security interest on a dwelling and made to finance the purchase of that dwelling, the total amount of finance charge,[11] with description of each amount included, using the term "finance charge."

(e) **Finance charge payable separately or withheld; required deposit balances.** The following amounts shall be disclosed and deducted in a credit sale in accordance with paragraph (c)(6) of this section, and in other extensions of credit shall be excluded from the amount disclosed under paragraph (d)(1) of this section, and shall be disclosed in accordance with paragraph (d)(2) of this section:

(1) Any finance charge paid separately, in cash or otherwise, directly or indirectly to the creditor or with the creditor's knowledge to another person, or withheld by the creditor from the proceeds of the credit extended.[12]

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[11] The disclosure required by this subparagraph need not be made with respect to interim student loans made pursuant to federally insured student loan programs under Public Law 89-329, Title IV Part B of the Higher Education Act of 1965, as amended.

[12] Finance charges deducted or excluded as provided by this paragraph shall, nevertheless, be included in determining the finance charge under § 226.4.

PUBLIC INFORMATION LETTERS

FEDERAL RESERVE BOARD PUBLIC INFORMATION LETTER NO. 379

July 28, 1970

Your letter raised questions concerning the interpretation of Section 226.8(e)(1) — "prepaid finance charge."

Your first question concerned the proper treatment of precomputed interest by either a "discount" or "add-on." Concededly the definition of a "pre-paid finance charge" is broad enough to include these terms and under present interpretation they may be so construed although they need not be, in our opinion.

Secondly, you inquire about the proper treatment of the "service fee" provided in Section 138.07 of the Wisconsin Banking Law. As we understand it, this provision applies only in the event of prepayment by the customer and provides that a certain amount of the finance charge is to be considered "earned." It would seem that this should be disclosed in accordance with Section 226.8(b)(7) as affecting the amount to be rebated to the customer in the event of prepayment.

Tynan Smith
Assistant Director

FEDERAL RESERVE BOARD PUBLIC INFORMATION LETTER NO. 397

August 7, 1970

As we understand the situation, your client imposes a charge for credit investigation and another charge for insurance to protect the client against loss. The amounts of these charges are added to the amount of the loan requested and although such charges are included in the finance charge and so disclosed, you ask whether such charges should also be disclosed as "prepaid finance charges."

We assume that the obligations to which you refer are the conventional conditional sales or instalment loan type contracts which involve an add-on finance charge. If such is the case, the charges you describe would be a part of the total add-on finance charges and discounts may be construed as coming within the concept of "prepaid finance charges," we have previously expressed the opinion that such charges need not be disclosed as "prepaid finance charges." It is therefore the opinion of the Board's staff that, if our assumption is correct, your client need not disclose the charges described as "prepaid finance charges."

Frederic Solomon
Director

FEDERAL RESERVE BOARD PUBLIC INFORMATION LETTER

January 18, 1972

In your letter of December 3, 1971, you raised several questions which regarded the treatment of "add-on" and "discount" loans with respect to the application of § 226.8(e)(1) of Regulation Z which deals with "prepaid finance charges."

[T]he Board's staff [has] indicated that the definition of "prepaid finance charges" could be construed to include finance charges computed by an "add-on" or "discount" method. However, * * *, the staff indicated its belief that such construction was not necessarily required and, therefore, such finance charges need not be disclosed as "prepaid finance charges."

You indicate that since there is a possibility that a court may construe finance charges computed by the "add-on" or "discount" method as "prepaid finance charges" several of your clients wish to treat them as such for disclosure purposes under Regulation Z. Staff believes that a treatment of finance charges computed by the "add-on" or "discount" method as "prepaid finance charges" would not constitute a violation under Regulation Z. Furthermore, portions of the finance charge in addition to interest, such as origination fees, and credit report fees (in a non-real property transaction) could also be treated as "prepaid finance charges" under the same rationale.

Griffith L. Garwood,
Chief, Truth in Lending Section

APPENDIX F

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 10, 1976

Mr. W. Rhett Tanner
Hansell, Post, Brandon and Dorsey
3300 First National Bank Tower
Atlanta, Georgia 30303

Dear Mr. Tanner:

I am writing in response to a letter of February 3, informing the Board of a decision on January 30 by the U.S. Court of Appeals for the Fifth Circuit in a case styled *Jones v. Community Loan and Investment Corporation of Fulton County*, Docket No. 74-3586.

The Court of Appeals' decision deals in part with the relationship between an interpretation of the Board's Truth in Lending regulation (§226.819), issued by the Board on August 31, 1973, and a loan fee charged under § 25-315(b) of the Georgia Code. Specifically, the question considered by the Court was whether such a loan fee constitutes a "prepaid finance charge," within the meaning of the Board's regulations as so interpreted by the Board.

In Interpretation § 226.819, the Board stated that precomputed finance charges included in the face amount of an obligation are not considered by the Board to be within the definition of "prepaid finance charges," as set forth in the Board's Regulation Z. In issuing that interpretation, the Board was aware that the United States District Court for the Northern District of Georgia had held, in *Grubb v. Oliver Enterprises, Inc.*, 358 F. Supp. 970 (N.D. Ga. 1972), that the Georgia loan fee should be considered a "prepaid finance charge" for purposes of Regulation Z. It was the Board's intention to make clear by this interpretation that such fees need not be considered "prepaid finance charges."

The Board takes no position on the merits of the controversy before the Court in the *Jones* case. However, the Board has authorized me to inform you that you, as counsel of record for appellee, may make this letter available to the Court in connection with your intended motion for reconsideration. If the Court should prefer that the Board's views be expressed directly in a brief *amicus curiae*, the Board would be pleased to comply.

Sincerely,

s / Theodore E. Allison

Theodore E. Allison
Secretary to the Board

APPENDIX G

UNITED STATES COURT OF APPEALS

FIFTH CIRCUIT

OFFICE OF THE CLERK

February 25, 1976

Edward W. Wadsworth
Clerk

Tel. 504-589-6514
600 Camp Street
New Orleans, La. 70130

To All Counsel of Record

No. 74-4183—Dealeaner Hammond vs. Public Finance Corp.

No. 74-3586—Rose E. Jones vs. Community Loan & Investment Corp. of Fulton County.

No. 74-3975—Homer Lee Slatter vs. Aetna Finance Co.

Dear Counsel:

At the direction of the court you are advised that any views the Federal Reserve Board may wish to express as to any matter affecting the court's opinion in this cause should be communicated by an amicus curiae brief filed in accordance with FRAP 29.

Should the Board choose to file a brief in this cause, it should be filed within 20 days of the date of this letter, and the parties to this appeal shall, within 20 days after such filing, respond with simultan-

eous briefs, stating their positions on the merits of rehearing in light of the Board's statements. Should the Board in its brief advise the court as to its intentions in adopting interpretative regulation § 226.819, the court requests that the response of the parties, *inter alia*, address the legal effect each party contends such advice by the Board may have in this case.

Yours very truly,

Edward W. Wadsworth, Clerk

By s / Gilbert F. Ganucheau

Gilbert F. Ganucheau
Chief Deputy Clerk

APPENDIX H

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

ROSE E. JONES
Plaintiff - Appellant,

vs.

COMMUNITY LOAN & INVESTMENT CORPORATION OF FULTON COUNTY
Defendant - Appellee

} Docket No. 74-3586

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF GEORGIA

BRIEF

of

The Board of Governors of the Federal Reserve System as *Amicus Curiae*

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES (Continued)

TABLE OF AUTHORITIES (Continued)

I. QUESTION PRESENTED

The issue in these consolidated cases is whether the Georgia loan fee imposed pursuant to § 25-315 (b) of the Georgia Code Annotated (1971) must be disclosed as a "prepaid finance charge" pursuant to 12 C.F.R. 226.8(d) and (e) as interpreted by 12 C.F.R. 226.819. The regulation at issue is part of the Federal Reserve Board's Regulation Z which implements the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*

II. INTRODUCTION

On January 30, 1976, the United States Court of Appeals for the Fifth Circuit decided the consolidated cases of *Rose Jones v. Community Loan and Investment Corporation of Fulton County*, Docket No. 74-3586, *Slatter v. Aetna Finance Company*, Docket No. 74-3975, and *Hammond v. Public Finance Corporation*, Docket No. 74-4183 (all three hereafter referred to as *Rose Jones*). The Board was not a party to the case, and it appears that the Court made an incorrect assumption regarding the Federal Reserve Board's intent in issuing the subject regulation and interpretation which assumption appeared to have a strong influence on the Court's decision in the case.

Appellees have moved for reconsideration and the Court, by letter dated February 25, 1976 (see Appendix), has indicated that any views that the Federal Reserve Board may wish to express as to any matter affecting the Court's opinion in *Rose Jones*, including the Board's intent in adopting 12 C.F.R.

226.819, should be communicated by an *amicus curiae* brief to be filed by March 16, 1976. Because of the importance of this case as a precedent under the Truth in Lending Act, the Board of Governors now appears as *amicus curiae* in order to explain the reasons for the development of the concept of the "prepaid finance charge" and to elucidate the Board's intent in adopting the subject regulation and interpretation.

III. THE PURPOSE OF THE TRUTH IN LENDING ACT IS TO PROVIDE CONSUMERS WITH A MEANINGFUL DISCLOSURE OF THE COST OF CREDIT TO ENABLE THEM TO SHOP FOR CREDIT IN AN INFORMED MANNER.

Congress passed the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, in order to assure "a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit" (15 U.S.C. § 1601). The Act reflects a concern that consumers could not shop prudently for credit because the methods used to compute the price of credit and the terminology employed by creditors in disclosing their prices were not uniform, thus making comparisons between creditors virtually impossible. For example, the consumer shopping for credit might find himself faced with a choice between taking a loan offered at an "add-on" rate of 6.5 per cent, a "discount rate" of $6 per hundred per year, or at a rate of one per cent per month on the unpaid balance of the loan. Con-

gress recognized that the average consumer could not make effective cost comparisons without the aid of uniform terminology and meaningful disclosures of credit terms.

The Truth in Lending Act, as implemented by Regulation Z, supplies the uniform terminology that is needed so that consumers may compare the cost of credit from one creditor to the next, regardless of the method used to compute and disclose that cost. The most important term for credit cost comparisons is the "Annual Percentage Rate" (hereafter APR). The APR represents the ratio of the "finance charge," which is the sum of all charges imposed directly or indirectly by the creditor as an incident to or as a condition of an extension of credit (in other words, the cost of the credit) to the "amount financed," which is the amount of credit of which the customer has the actual use. This ratio is related to the repayment terms. Regulation Z imposes uniform requirements for determining the "finance charge" and the "amount financed" so that the APR's calculated and disclosed for any consumer credit transactions can be compared. The object of Regulation Z is to insure that consumers shopping for credit can determine without difficulty which of any two proposed loans is the less costly. Following the enactment of Truth in Lending, a consumer shopping for credit can be assured that a loan with an APR of 12 per cent is less expensive than a loan with an APR of 15 per cent.

While the Truth in Lending Act provided a conceptual basis for calculation of the APR, the very difficult task of actually developing a computational

framework which would have universal application to all of the myriad forms that consumer credit transactions might take was delegated to the Federal Reserve Board. As noted by this Court in *Philbeck v. Timmers Chevrolet, Inc.*, 499 F.2d. 971,976 (5th Cir. 1974), Congress decided to lay the structure of the Act broadly and entrust its construction to the Federal Reserve Board which was given extremely broad regulatory and rulemaking powers to effectuate the purposes of the Act. The Board's Regulation Z, which became effective on July 1, 1969, embodies, *inter alia*, the disclosure requirements of the Act as well as the framework developed by the Board for determining the "finance charge" and the "amount financed," and for calculating the corresponding APR for any credit transaction subject to the Act. The Board has the continuing authority and responsibility to amend and interpret Regulation Z whenever it is of the opinion that such action is necessary to effectuate the purposes of the Truth in Lending Act (15 U.S.C. § 1604).

IV. THE CONCEPT OF THE PREPAID FINANCE CHARGE WAS DEVELOPED BY THE BOARD FOR THE SOLE PURPOSE OF ASSURING THAT THE AMOUNT FINANCED ALWAYS REFLECTS THE AMOUNT OF LOAN PROCEEDS OF WHICH THE DEBTOR HAS ACTUAL USE.

The sole issue in *Rose Jones* involves the correct treatment under Regulation Z of the Georgia loan fee collected pursuant to § 25-315(b) of the Georgia Code Annotated (1971). There is no doubt that the Georgia loan fee constitutes a finance charge under

the Act. The Court recognized this fact but held, in addition, that 12 C.F.R. 226.8(d)(1) and (2) in conjunction with 12 C.F.R. 226.8(e)(1) require that the Georgia loan fee be disclosed as a "prepaid finance charge." Apparently, the Court assumed that the Board's purpose in defining this term was to insure explicit disclosure to consumers of so-called "prepaid items." However, the Board's only purpose in defining "prepaid finance charge" was to insure that charges described by this term are not included in the "amount financed." In the Board's view, the definition of "prepaid finance charge" does not turn on the status of particular credit charges under Georgia law, or on the question of when such charges are "earned."

The concept of a "prepaid finance charge" does not appear anywhere in the Truth in Lending Act. In drafting Regulation Z, the Board developed this concept to deal with the potentially troublesome situation in which a creditor, while ostensibly complying with the Act, could frustrate its purpose by denying the debtor the actual use of some or all of the credit purported to be extended. This is best illustrated by an example.

> Debtor contracts with Creditor for a loan of $1,000 to be repaid in a lump sum at the end of one year with add-on interest in the amount of $200. Creditor also charges a loan fee of $50 to be paid at the time the loan transaction is consummated.

In the example, there are two ways in which Creditor may effect collection of the loan fee: he may

disburse the $1,000 loan proceeds to Debtor and demand immediate payment of $50 in cash or he may simply withhold $50 from the loan proceeds and disburse the remaining $950 to Debtor. Under either alternative, it would appear, on first impression, that the APR ought to be calculated using the following figures:

Amount Financed	=	$1,000
Finance Charge	=	250
Annual Percentage Rate	=	25%

However, this calculation does not give an accurate picture of what actually happened in this credit transaction. Debtor did not have the actual use of the full $1,000 which he attempted to borrow because Creditor required an immediate payment of the $50 loan fee out of the proceeds of the loan. Consequently, Debtor only received the actual use of $950 for a finance charge of $250. Thus, the APR should have been calculated on an "amount financed" of only $950, making the correct APR 26.25 per cent.

The preceding example illustrates the reason for the development of the concept of the "prepaid finance charge." *Its sole purpose was to assure that, in transactions in which payment of any portion of the finance charge reduces the amount of the proceeds of the loan actually received by the debtor, the "amount financed" is adjusted to reflect the true amount of loan proceeds of which the debtor had actual use.* Without this adjustment to the "amount financed," the APR would be understated.

V. IN VIEW OF THE REASON FOR THE DEVELOPMENT OF THE CONCEPT OF THE PREPAID FINANCE CHARGE, CHARACTERIZATION OF THE GEORGIA LOAN FEE AS "EARNED" SHOULD BE IRRELEVANT TO THE DECISION AS TO WHETHER IT MUST BE DISCLOSED AS "PREPAID."

The opinion in *Rose Jones* places great emphasis on the fact that the Georgia loan fee is fully earned when the loan contract is entered into and that prepayment of the obligation does not entitle the debtor to a refund of any portion of that fee:

> "The loan fee was required by statute and regulation to be shown as a part of the finance charge (citations omitted). But showing it as a finance charge without more would be misleading. As a one time expense due at the outset, the loan fee is different from the typical add-on charge which may later be recovered if not earned or expended with the passage of time over the life of the transaction. *The necessity to make this difference plain to the borrower is precisely why Regulation Z requires that the customer be told that this segment of the finance charge is prepaid." Rose Jones v. Community Loan and Investment Corporation of Fulton County, supra,* p. 1589 (emphasis supplied)

The opinion makes this same assertion later:

> "The heart requirement of the Consumer Credit Protection Act is disclosure which is meaningful to the buyer. The obvious intent of requiring the labeling of an item as 'prepaid' would be to in-

form the borrower that the charge indicated has already been paid out by him or for his account at the time of the extension of the credit and, as importantly, that it is a charge that will not be returned if the loan is paid off prior to maturity." *Rose Jones v. Community Loan and Investment Corporation of Fulton County, supra,* p. 1590

The Board agrees that it is important for the borrower to be informed that one component of the finance charge has been earned at the outset and therefore is not recoverable in the event of prepayment and, in fact, the Court noted in footnote 4 to its opinion that the borrowers in these cases were informed of this fact.[1] However, the Board respectfully submits that characterization of the loan fee as "earned"

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[1] Footnote 4 to the Court's opinion in *Rose Jones* notes that:

"The Jones note provided:

On prepayment of the obligation, any unearned portion of the interest shall be refunded using the Sum of the Digits Rule. *The fee is not refundable,* however, creditor shall not receive charges in excess of 5% per month and any such excess charges accruing upon prepayment shall be refunded.

The Slatter note provided:

In the event of prepayment in full prior to maturity a refund of that portion of the Finance Charge designated above as Interest Charges will be made according to the Rule of 78ths. *Loan fees are not subject to refund* except that in no event will the Lender retain from the interest charges and fees combined, a rate greater than 5% per month. No refund of under $1.00 will be made.

The Hammond note provided:

PREPAYMENTS: Refunds for prepayment are computed by the sum of the digits method (Rule of 78) *on originally scheduled regular charge.* Refunds of less than $1.00 are not made." (emphasis supplied)

should have no bearing on the determination of whether the charge is to be labeled a "prepaid finance charge." "Earned" and "prepaid" are not identical concepts; a "prepaid finance charge" does not have to be "earned." The Board's purpose in adopting the term "prepaid" was not to compel disclosure of "earned" items so as to indicate whether a charge is recoverable in the event of prepayment of the obligation. Rather, the Board's purpose, as previously stated, was to insure the accuracy of the creditor's computation of the "amount financed." This fact was clearly stated in Interpretation 12 C.F.R. 226.819:

"The concept of prepaid finance charges was adopted to insure that the 'amount financed' reflected only that credit of which the customer had actual use."

In cases where the loan fee is precomputed and instead of being paid immediately, is added to the face amount of the obligation to be paid over the term of the obligation, no adjustment to the "amount financed" is necessary in order for it to accurately reflect the amount of loan proceeds of which the debtor has actual use. And inasmuch as the "amount financed" is correct, the APR calculated will be the same whether or not the added-on charge is labeled "prepaid."[2]

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[2] The following fact situation and example disclosures illustrate that, in the case where a loan fee or other precomputed finance charge is added to the face amount of the obligation and excluded from the "amount financed," there is no difference in the APR calculated whether the loan fee or other finance charge is disclosed as a "prepaid finance charge" or as an ordinary finance charge.

VI. INTERPRETATION 12 C.F.R. 226.819 WAS NECESSARY BECAUSE CONFUSION HAD ARISEN AS TO WHETHER PRECOMPUTED FINANCE CHARGES WHICH ARE ADDED TO THE FACE AMOUNT OF THE OBLIGATION BUT EXCLUDED FROM THE AMOUNT FINANCED MUST BE DISCLOSED AS "PREPAID FINANCE CHARGES" OR MAY BE DISCLOSED, IN THE ALTERNATIVE, MERELY AS "FINANCE CHARGES."

In drafting the description of "prepaid finance charges" in 12 C.F.R. 226.8(e), the Board attempted

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[2] (continued)

Fact Situation

Borrow	$1,000
Add-on Finance Charge	150
Loan Fee	50
Face Amount of Obligation	$1,200

Loan to be repaid in 12 monthly instalments of $100 each.

This hypothetical corresponds to the situation in *Rose Jones*. As shown above, the loan fee is paid over the life of the obligation by adding it to the face amount of the obligation and calculating the monthly payments on this total. The amount borrowed of which the debtor receives actual use is not diminished by payment of the loan fee because the face amount of the obligation includes the $50 that will pay the fee; thus, the borrower gets actual use of the full amount borrowed ("amount financed") of $1,000.

The Board has taken the position in 12 C.F.R. 226.819 that the loan fee, in a case where the amount of the loan fee is precomputed and added to the face amount of the obligation but excluded from the "amount financed," may be disclosed either as an ordinary finance charge (itemized if not the only component of the finance charge) or as a "prepaid finance charge." The disclosures for this example fact situation could be made in either of the following manners:

to delineate the situations in which a finance charge must be labeled "prepaid" and deducted from the "amount financed." Because the concept was a new one that did not lend itself to a succinct description, some confusion over the interpretation of this concept developed among creditors.

The confusion arose primarily from the description in 12 C.F.R. 226.8(e) of a "prepaid finance charge" as "any finance charge . . . withheld by the

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[2] (continued)

	Fee as "Prepaid"		Fee not as Prepaid
Borrow (Unadjusted Amount Financed)	$1,000		
Add: Loan Fee Financed	50		
Subtotal	1,050		
Deduct: Prepaid Finance Charge	50		
Amount Financed	$1,000		$1,000
Finance Charge			
Loan Fee	$ 50	$ 50	
Interest	150	150	
	$ 200		$ 200
Face Amount of Obligation (Total Payments)	$1,200		$1,200
Annual Percentage Rate (Consult Tables)	35%		35%
Terms:	12 monthly instalments of $100 each		12 monthly instalments of $100 each

It is important to note that the APR is the same whether or not the loan fee is disclosed as "prepaid." In comparing the disclosures, it should be noted that when the disclosure is made using the "prepaid" label, as was held to be mandatory in *Rose Jones*, it results in unnecessary computational steps. First, the loan fee is added to the amount borrowed and then it must be deducted to arrive at the "amount financed." These steps add nothing to the disclosures and the Board believes that the Regulation does not mandate them.

creditor from the proceeds of the credit extended." This phrase is susceptible to a construction different from that originally intended by the Board as it might seem to encompass any "add-on" or "discount" finance charges which are included in the face amount of the obligation. For example, where a single repayment loan of $1,000 with an add-on finance charge of $200 is contracted for, the face amount of the note would be $1,200 even though the debtor would only receive $1,000. If the face amount of the obligation were viewed as the "amount of credit extended," the $200 of finance charges might be characterized as "withheld by the creditor from the proceeds of the credit extended." However, it is not necessary to identify the $200 as a "prepaid finance charge" in order to insure accuracy of the "amount financed."

As a result of this unintended breadth of interpretation of the description of "prepaid finance charges" in 12 C.F.R. 226.8(e), the Board received numerous requests for clarification and inquiries as to the proper method of disclosing "add-on" or "discount" finance charges. In responding to such requests, Board staff took the position that:

> ". . . the definition of 'prepaid finance charges' could be construed to include finance charges computed by an 'add-on' or 'discount' method. However . . . such construction [is] not necessarily required and, therefore, such finance charges need not be disclosed as 'prepaid finance charges.' "[3]

[3] Public Information Letter dated January 18, 1972, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶ 30,794; See also Letter 379, July 29, 1970, *CCH Consumer*

However, despite the explanatory staff opinion letters, a great deal of confusion and uncertainty still remained among consumers, creditors, and the courts, and the Board felt that some formal action to clarify this issue so as to avoid unnecessary and confusion-causing litigation was warranted. Thus, on August 23, 1973, the Board promulgated Interpretation 12 C.F.R. 226.819 to respond to the question of "whether add-on, discount or other precomputed finance charges which are reflected in the face amount of the debt instrument as part of the customer's obligation, but which are excluded from the 'amount financed,' must be labeled as 'prepaid' finance charges" (12 C.F.R. 226.819).

This interpretation adopts the position, previously taken in the staff opinion letters, that precomputed finance charges which are included in the face amount of the obligation may be disclosed either as "prepaid finance charges" or as ordinary finance charges. The Board based this position on the fact that its sole purpose in developing the concept of the "prepaid finance charge" was to assure that the "amount financed" was stated accurately; since in the situation where a precomputed finance charge is added to the face amount of the obligation and collected over the life of the loan, the "amount financed" and the APR would be the same regardless of which method of disclosure ("prepaid" or ordinary finance charge) was chosen,[4] the Board felt

Credit Guide, 1969-1974 Transfer Binder ¶ 30,560; Letter 397, August 7, 1970, *CCH Consumer Credit Guide*, 1969-1974 Transfer Binder ¶ 30,581.

[4] See footnote 2 *supra*, pp. 8-9.

that this was the most reasonable and least disruptive way to deal with the problem. This approach also took account of the fact that staff had consistently taken the position that disclosure in either manner would constitute compliance with Regulation Z and creditors who had relied on staff Public Information Letters or on their own reasonable construction of 12 C.F.R. 226.8(e) might inequitably be exposed to liability were a different approach taken at this time.

VII. THE BOARD'S INTERPRETATION 12 C.F.R. 226.819 WAS INTENDED TO APPLY TO PRECOMPUTED FINANCE CHARGES SUCH AS THE GEORGIA LOAN FEE AND, IN FACT, THE BOARD SPECIFICALLY HAD THE GEORGIA LOAN FEE IN MIND IN DRAFTING AND ADOPTING THE INTERPRETATION.

The opinion in *Rose Jones* mentions the Board's Interpretation 12 C.F.R. 226.819, but dismisses it as inapplicable to the Georgia loan fee because the preamble to the interpretation refers to the "*typical*" add-on or discount charge which, according to the opinion, the Georgia loan fee is not. The opinion states that the Georgia loan fee is not a typical add-on charge because it is fully earned at the time the transaction is entered into and, therefore, cannot be recovered in the event of prepayment of the obligation.

The word "typical" does appear in the preamble to the Board's interpretation. However, the preamble is not an operative part of the interpretation. "Pre-

ambles to codified documents describe the contents of the document in laymen's language .... Preambles are not usually published in the Code of Federal Regulations and, of course, do not include any regulatory provisions."[5]

Even assuming that the preamble has regulatory relevance, the preamble, in its entirety, states:

> "This interpretation intends to make clear that the typical 'add-on' or 'discount' charge *or other precomputed finance charge* on an instalment contract or other obligation need not be labeled a 'prepaid' finance charge."[6] (emphasis supplied)

The opinion appears to have ignored the "or other precomputed finance charge" language in holding that the interpretation does not address finance charges such as the Georgia loan fee.

More importantly, however, the Board clearly intended that its interpretation should apply to finance charges such as the Georgia loan fee in those cases when the fee is precomputed and added to the face amount of the obligation for collection over the life of the loan. The Board has indicated this fact in a letter to Mr. W. Rhett Tanner dated February 10, 1976:

> "In issuing [12 C.F.R. 226.819], the Board was aware that the United States District Court for the Northern District of Georgia had held, in

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[5] Federal Register Document Drafting Handbook (Issued pursuant to the Federal Register Act, 44 U.S.C. Ch. 15) Office of the Federal Register, Washington, D.C. (January, 1975), p. 13.

[6] Preamble to Interpretation 12 C.F.R. 226.819.

Grubb v. Oliver Enterprises, Inc. 358 F. Supp. 970 (N.D. Ga. 1972), that the Georgia loan fee should be considered a 'prepaid finance charge' for purposes of Regulation Z. It was the Board's intention to make clear by this interpretation that such fees need not be considered 'prepaid finance charges.' "

The Board expresses no opinion as to whether the fact that the Georgia loan fee is not recoverable in the event of prepayment of the obligation removes it from the category of "typical," although it should be noted that numerous States have laws which sanction the collection of loan acquisition fees which are considered fully earned upon consummation of the transaction and are not refundable in the event of prepayment.[7] Thus, collection of charges such as

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[7] Following is a listing of some of the State laws providing for the collection of a loan fee which is considered earned upon consummation of the loan transaction and, therefore, is not refundable in the event of prepayment of the obligation (this is not intended as a comprehensive listing of all such laws):

1. Connecticut Industrial Bank Law, Connecticut General Statutes Annotated § 36-148 (1969)
2. Delaware Discount Act, Delaware Code Annotated § 5-2108 (1975)
3. Florida Industrial Bank Law, Florida Statutes Annotated § 656.17 (1966)
4. Georgia Industrial Loan Act, Georgia Code Annotated § 25-315(b) (1971)
5. Iowa Industrial Loan Act, Iowa Code Annotated § 536A.23 (Supp. 1975)
6. Kentucky Industrial Loan Act, Kentucky Revised Statutes § 291.460 (1969)
7. Minnesota Industrial Loan Act, Minnesota Statutes Annotated § 5-1307 (1970) (earned unless note renewed or paid off in first 12 months)

those imposed by the Georgia loan fee are not totally atypical.

In light of the foregoing, there should be no doubt that 12 C.F.R. 226.819 was intended to apply to finance charges such as the Georgia loan fee when they are precomputed and added to the face amount of the obligation for collection over the life of the loan.

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[7] (Continued)

8. Montana Morris Plan Company Law, Revised Codes of Montana § 5-1307 (1968)
9. Ohio Second Mortgage Act, Ohio Revised Code § 1321.57 (Supp. 1974)
10. Virginia Industrial Loan Companies Act, Code of Virginia § 6.1-234 (1973)
11. Washington Industrial Loan Act, Revised Code of Washington Annotated § 31.04.090 (1961)
12. West Virginia Industrial Loan Company Law, West Virginia Code Annotated § 31-7-11 (1975)

APPENDIX

United States Court of Appeals
Fifth Circuit
Office of the Clerk

February 25, 1976

TO ALL COUNSEL OF RECORD

74-4183—*Dealeaner Hammond v. Public Finance Corp.*

74-3586—*Rose E. Jones v. Community Loan & Investment Corp. of Fulton County*

74-3975—*Homer Lee Slatter v. Aetna Finance Corp.*

Dear Counsel:

At the direction of the court you are advised that any views the Federal Reserve Board may wish to express as to any matter affecting the court's opinion in this case should be communicated by an *amicus curiae* brief filed in accordance with FRAP 29.

Should the Board choose to file a brief in this cause, it should be filed within 20 days of the date of this letter, and the parties to this appeal shall within 20 days after such filing respond with simultaneous briefs, stating their positions on the merits of rehearing in light of the Board's statements. Should the Board in its brief advise the court as to its intentions in adopting interpretative Regulation 226.819 the court requests that the response of the parties,

inter alia, address the legal effect each party contends such advice by the Board may have in this case.

Yours very truly,

Edward W. Wadsworth
Clerk

by Gilbert F. Ganucheau
Chief Deputy Clerk

CERTIFICATE OF SERVICE

I certify that I have this day mailed, by First Class United States Mail, with sufficient postage attached thereto to insure delivery, the foregoing brief *amicus curiae* of the Board of Governors of the Federal Reserve System to the following counsel of record in the above cause:

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This 16 day of March, 1976.

/s/ MARK S. MEDVIN

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